

ASPECTS OF ECONOMIC <sup>POLICY</sup> ~~IN EGYPT~~ IN EGYPT  
1970 ~~1970~~ 1980

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THESIS FOR THE PhD DEGREE

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This Thesis analyses Egyptian economic policy making in the 1970s. Despite recommendations for decentralisation and greater use of market forces, only limited reforms occurred. These resulted in a big increase in resources available and the development of new sectors. A central hypothesis put forward is that the interaction of the sectors made reform hard. These were strong incentives to maintain the status quo and not decentralise public sector plus government decision making. These included the need to maintain employment in the public services in view of the overall shortage of jobs. There was also pressure to maintain the country's socialist legacy so as to maintain the loyalty of the urban working classes. The impact of rent seeking activity is looked at as a source of inertia, preventing reform.

As a result of these pressures the government felt able to reform the foreign sector but not the domestic economy. Changing the trade and exchange systems would create new opportunities which were not available, or not thought to be available in industry and agriculture.

The problems encountered in economic policy making are examined in four broad areas. The investment and planning system is analysed in order to see how consistent and comprehensive development strategy was. Pricing policy is dealt with in relation to cotton and public industry because of its importance in the economy. The implications of these policies are then examined in terms of public finance and the monetary consequences of the budget deficit. Finally, the foreign sector is looked at with special attention to the areas of opportunity: oil revenues, Suez Canal tolls and emigrant remittances.

Conclusions are then drawn about the effects of the liberalisation and the reasons why it took such a partial form.

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## Chapter 1: Introduction

This thesis will examine the way in which economic policy was made and implemented in Egypt between 1970 and 1980. The aim is to show how economic problems have persisted despite changes in policy. The implication of the analysis is that the problems which Egypt has faced were, at least in part, the result of the way in which policies were chosen and implemented.

Despite increased foreign aid, petroleum revenues and emigrant remittances received in the 1970s compared with earlier periods, serious problems persisted. The domestic economy- industry and agriculture - were perceived by policy makers to offer a lack of opportunity for development compared with the foreign sector. Liberalisation of the economy was, therefore, uneven. Foreign trade controls were eased and the exchange rate system reinforced, but little was done to enable industry and agriculture to expand. The way in which these issues were perceived affected the policy choice and implementation. The thesis will show the way in which many basic issues were in fact evaded. The lack of a clear ideology and consensus about economic policy meant that the President and his ministers had to make statements about their objectives which were often contradictory.

The regime had weak political roots, especially after the 1967 defeat, and so it had to avoid upsetting any powerful group in society. Although the general drift of policy was towards the greater use of the market mechanism, it was far from consistent. As a result, tough decisions were avoided or, when made, retracted. The failure to make tough decisions about consumption meant that the economy in the 1970s, as in the 1960s, remained in need of foreign aid.

The hypothesis that economic policy did not receive sufficient attention will be illustrated by looking at the lack of economic priority in the period before 1973 and the reactive nature of decision making since then. A key issue is the way in which policies were not carried through to their logical conclusion so that organisations in the economy faced conflicting guidelines as to what their objectives were.

Much of the economic literature on Egypt has dealt with the consequences of policies adopted, rather than the reasons for their adoption. Mabro and Radwan (1) were concerned with the industrialisation process until 1973; Hansen and Nashashibi (2) and Girgis (3) examined the foreign trade sector in the period ending in the mid 1970s. None of these writers dealt with the question of how and why policies were selected, except in passing. Yet the issues involved in that choice and in implementation underlie much of their discussions. According to Mabro and Radwan for example, the problems in industry after 1962 were those of increasing labour costs arising from organisational defects, redistributational policies, supply bottlenecks and a deterioration of the relationships within firms, among other things (4).

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(1) R. Mabro and S. Radwan 'The Industrialisation of Egypt 1939-1973' Clarendon, 1976.

(2) B. Hansen and K. Nashashibi 'Egypt: Foreign Trade Regimes and Economic Development', National Bureau for Economic Research, 1975.

(3) M. Girgis 'Industrialisation and Trade Patterns in Egypt', JCB Mohr, 1977

(4) R. Mabro & S. Radwan, op cit P.50.

Two studies which cover the period until the end of the 1970s are those Ikram(1) plus Hansen and Radwan(2). They surveyed the economy from the general and employment perspectives respectively and commented, inter alia, on the weaknesses of the policymaking and implementation systems. Yet Ikram, echoing Mabro and Radwan, points out that little could be said about improvements in managerial and technological efficiency because of the lack of data. (3).

Ikram related 'X efficiency' to problems of wastage of inputs and raw materials in the production process. This was in part due to out-dated and badly maintained machinery, lack of supervision and incentives and negligent labour. (4). He also included such issues as the uneconomic use of long staple cotton in manufacturing coarse yarn and cotton. This was a result of the industrialisation strategy, pricing and foreign trade systems which overrode considerations of comparative costs. The implication was that policy at the strategic level was at fault.

Both sets of factors need explanation. Part of this can be given by examining the decision making process as well as the mechanisms for implementation and control. The manager in Egyptian public sector industry faced numerous constraints. His ability to hire, fire, promote and demote was tightly restricted by the government. Decisions about production were, for the most part, determined by the government

- (1) K. Ikram 'Egypt: Economic Management in a period of Transition', John Hopkin's University Press, 1980.
- (2) B. Hansen & S. Radwan 'Employment Opportunities and Equity in a Changing Society: Egypt in the 1980's' I.L.O. 1982.
- (3) K. Ikram Op Cit P25.
- (4) K. Ikram Op Cit P257-8

through its pricing and investment policies. Inputs depended on factors beyond his control. In many respects he was no more than a bureaucrat following narrowly prescribed rules. The reasons why the government maintained this control, even though it was supposedly trying to liberalise the economy, are central to this thesis.

Explanations of managerial inefficiency are a lacuna in the economic literature. Some explanations have been provided by political scientists. Ayubi's (1) study of bureaucracy and Cooper's of the state (2) throw some light on the decision making system at the bureaucratic and political levels. At the level of the firm, Baker (3) analysed the problems faced by managers in what he called the uncertain worlds of Nasser and Sadat. The link between these analyses and the performance of the economy is a vital one.

The Government, through the bureaucracy, dominated the economy in the 1970s, despite moves towards economic decentralisation. An analysis of the way which decision were made and implemented will show how the environment in which firms operated changed. This provides part of the explanation of the difficulties faced in improving managerial efficiency.

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(1) N. Ayubi 'Bureaucracy & Politics in Contemporary Egypt', Ithaca Press, 1980.

(2) M. Cooper 'The Transformation of Egypt', Croom Helm, 1982.

(3) R. Baker 'Egypt's Uncertain Revolution under Nasser & Sadat' Harvard University Press, 1978.

O'Brien carried out an analysis of this kind for the early 1960s.(1) He examined changes in economic organisations, concentrating on the political, legal and institutional framework as well as economic performance. His study published in the mid 1960s came too early to evaluate the First Five Year Plan. Yet the problems which he looked at and his conclusions are of relevance for the 1970s because there was so much continuity in the institutions and economic structure.

The general literature on economic development has focused to a large extent on three issues. Firstly how far the market should rule. The second and closely related issue is whether foreign aid, trade and investment should be encouraged. The third question has been the choice between sectors (for example industry versus agriculture). The issue of why policy towards the market mechanism has changed had been discussed extensively with regard to communist countries (2). In the context of the non-communist developing world most analysis is prescriptive.

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(1) P. O'Brien 'The Revolution in Egypt's Economic System', Oxford University Press, 1966.

(2) eg. A. Nove 'The Soviet Economic System' George Allen & Unwin 1961  
D. Milenkovitch 'Plan and Market in Yugoslav Economic Thought', Yale University Press 1981.



Recommendations are made for movements towards the greater use of market forces in order to maximise a growth or welfare function (1) but analysis of the reasons why such changes occur are scarce. Myrdal (2) has dealt with these issues very generally and Paauw and Fei gave a detailed analysis of the influences of different groups and classes on policy in some South East Asian countries (3). Abdel Fadil also assessed these issues for Egypt in Nasser's period (4). This thesis will attempt to explain the reasons for policy changes in the 1970s.

Egypt in the 1970s presented a more complex pattern than it did even in the 1960s. Its economic ideology had partly changed but policies vis a vis sectoral balances had not. A move towards the market mechanism (particularly in the foreign sector) did not result in a reduction of investment in heavy industry, or more resources for agriculture. It therefore presents a case study which transcends many of the classifications which have been made in the literature.

An explanation for this will be provided in the following terms. The government wanted to please as wide a constituency as possible with its policies, at least among the urban population.

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- (1) I. Little T. Scitovsky & M. Scott 'Industry & Trade in Some Developing Countries', Oxford University Press 1970, and a decade later A. Krueger 'Liberalisation Attempts and Consequences', National Bureau of Economic Research, 1978.
  - (2) G. Myrdal 'Asian Drama' Pantheon, Random House, 1968.
  - (3) D. Paauw & J. Fei 'The Transition in Open Dualistic Economies' Yale University Press, 1973.
  - (4) M. Abdel Fadil 'The Political Economy of Nasserism', Cambridge University Press, 1980.

Liberalising foreign trade and increasing access to foreign exchange enabled the upper middle classes to import many of the consumer goods which in the 1960s had been short in supply. Opening new sectors of activity to the private sector enabled those with investment funds to increase their incomes.

By maintaining its ownership and control of the public sector, the regime ensured that the mass of the urban population would remain in employment with incomes effectively guaranteed by the state. Expanding the bureaucracy prevented growing unemployment among graduates and others coming onto the labour market. Permitting emigration also helped to reduce excess supply on the domestic labour market and through remittances in cash and kind increased real incomes and consumption throughout the economy.

The final part of this implicit social contract was the system of subsidies on basic commodities. This enabled the poor, particularly in urban areas, many of whom had little formal employment and very low incomes, to subsist despite increases in international and domestic prices.

In ideological terms, the socialist legacy was maintained at least in name. At the same time the private sector was encouraged and Egypt moved towards closer economic links with the Arab oil states and then with the West.

These arrangements had two main economic characteristics. First their budgetary and non-budgetary cost rose over time. This was because the population grew at the same time as food self-sufficiency declined. The second characteristic of the system was its rigidity. It could not adjust to changing economic circumstances easily and so distortions and inefficiencies arose and grew. These factors paradoxically made reform harder.

The concept of rent-seeking is of relevance in explaining some of these factors.

According to Ricardo (1) rent is what is paid for the use of the 'original and indestructable powers of the soil'. Krueger adopted the Ricardian definition to cover legal and illegal competitive seeking of the returns from commodities in short or fixed supply (2). Her main example was the effect of quantitative restrictions (QRs) on imports into developing countries. Economic agents bid for import licences in such situations and pass on the cost of what they have to pay (a licence fee or bribe) to the consumer.

An important point about rent-seeking is that, although each importer may get fewer imports than he would if licences were replaced by tariffs, he still gets a profitable return. Paradoxically, therefore, an economy in which the government intervenes through QRs and other controls (such as minimum wage rates and interest rate ceilings) can result in profits for entrepreneurs on the basis of their competitive activity.

Hansen and Nashashibi (3) calculated some of the cost controls on imports. The purpose of this thesis is to show how rent-seeking played a role in policy making, rather than to quantify its economic costs.

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- (1) D. Ricardo 'On the Principles of Political Economy and Taxation' P91, Pelican Classic Ed. London 1971.
  - (2) A.O. Krueger 'The Political Economy of the Rent Seeking Society' American Economic Review, July 1974 P291-303.
  - (3) B. Hansen & K. Nashashibi 'Egypt: Foreign Trade Regimes and Economic Development', National Bureau for Economic Research, 1975.

The concept of rent and rent-seeking had a number of applications. The development of the oil sector most closely approximates the Ricardian concept, because it represented a gift of nature. The Suez Canal involved capital and managerial input, but its economic value was derived from its geographical location. The tolls which it earned were, therefore, a form of rental income. Part of the Open Door Policy involved the development of warehousing in the Suez Canal zone. Income from this activity accrued to Egypt as a result of the Canal and its value as a trans-shipment zone. Hopes that the goods stored in the zone could be used as a form of collateral were also based on the idea of rent.

Tourism revenue can also be considered to have a rent element. Egypt attracted visitors to see its archaeological sites. They were a gift of history, although some input of labour and management was involved.

All of these sectors can be considered as rental or semi-rental (tourism) in that the income earned from them was not the result of production in economy. Rental incomes were earned elsewhere in the economy, on a larger scale however.

Krueger's concept related to the way in which industry and agriculture were run and the relationship between the liberalised sectors and the state. The Open Door Policy envisaged the creation of new sectors which would operate with the approval of the bureaucracy. This offered large scale opportunities for acquiring rent. Equally significantly it provided work, a *raison d'être* and even extra income, for officials. The liberalisation did not replace the state with the market or even significantly reduce its role. It did increase the area of interaction between badly paid bureaucrats and rent seekers. The bureaucrats therefore acquired rent in their transactions.

The focus of the thesis required extensive interviewing of managers, officials, ministers, former ministers and others in Cairo. The purpose of the interviews was to find out why and how decisions were made and implemented. Crucial to an understanding of this process was the question of perceptions. Boulding (1) has noted that decision makers do not respond to objective facts but to their own perceptions of a situation. They therefore need to be seen in the context of the institutions and environment in which they operate. This is particularly important given the hypothesis put forward here that the bureaucracy itself was a major constraint on policy making plus implementation and was, in itself, a major issue for policy makers. Given these problems and the dominance of the public sector in the economy, an examination of the state is central. Dealing with these institutional factors will make it possible to pinpoint areas where rent seeking was influential in directing policy.

The State's administrative machine for controlling the economy had three levels. At the top was the President with extensive power over all matters. He had no effective department of his own and used the cabinet, plus personal advisors, to deal with economic issues. For most of the decade President Sadat was mainly concerned with foreign and military policy. He laid down strategic guidelines for the economy and on occasion intervened in details. Ministers and senior officials formed the second level. They provided the technical (and sometimes political) skills for the implementation of policy at the detailed level. Their tenure was limited by the need for scapegoats to blame for policy failures and by the unwillingness of Sadat to permit any

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(1) K. Boulding 'National Images and International Systems' Journal of Conflict, Resolution, June 1959.

individual to remain in office for long enough to build up their own power base. The President was willing to trade administrative efficiency for political loyalty. Ministers controlled the bureaucracy.

The number of civil servants grew from 1.2 millions between 1969/70 to 2.0 millions in 1978 (1). By 1980 the figure may have been as high as 2.3 million (2). A large percentage of them had little education and no real function but the government was committed to providing jobs for the thousands of graduates and non-graduates coming onto the labour market each year.

This system was directly responsible for controlling the large public industrial sector and for influencing the rest of the economy towards the government's objectives. The internal problems of the administration and contradictory policy objectives made for economic problems.

A successful economic system needs to motivate people, monitor their performance and coordinate their activities. It needs to provide incentives for efficiency and disincentives to waste. For this, accountability is essential (3). Somehow, individuals and groups need to be answerable for what they do both within and outside the formal organisation. Within it they need to be responsible to their superiors, outside it they need to be monitored by some kind of public or state representation. The measurement of output in administration is notoriously hard to calculate and so, as the economy became more bureaucratic, the problem of assessing, monitoring and rewarding

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(1) See Table 3, Chapter 2.

(2) Data from interview at Ministry of Finance.

(3) H.A. Simon 'Administrative Behaviour', Pl35, Macmillan, 1961.

economic performance grew.

Government administration was accountable to the President and to a small extent to Parliament. It was, in the 1970s, a mainly closed system and was not therefore fully open to scrutiny and public criticism. This had major consequences for administration and public sector industry which will be looked at. Examining the role of rent seeking within the public sector and administration will help to show why legal incentives and accountability were not developed.

Egypt's poverty imposed two constraints on the government before it could deal with anything else. Firstly, large subsidies were needed to enable the mass of the population to pay for necessities. Secondly, the government somehow had to find tens of thousands of jobs each year for graduates and non-graduates entering the labour market each year. The implications of these factors are examined with regard to financial and monetary policies and in terms of their effects on the external sector. The second part of the thesis also examines the effects of policies designed to control the firm. Planning, investment and pricing policies extended bureaucratic controls to firms with consequences throughout the economy. It is the relationship between policies, their effects on each other, rather than the economic effects of policies per se which is central. This will help to show how policy makers responded to problems.

The consequences of these administrative arrangements, coupled with the liberalisation of the foreign sector, were felt in terms of the state budget. The budget deficit was a major issue in economic policy and its financing will be analysed.

Part of the feedback of one policy into another comes from the effects of policies on the economy. It is, therefore, necessary to see how the economy changed in the 1970s.

The economy suffered similar problems in the 1960s and 1970s. The population continued to grow at over 2% p.a. Between 1947 and 1979 it doubled, while the area of land under cultivation increased by under 5%. The cropped area (cultivated area multiplied by the cropping intensity) increased by less than 20% and so each feddan (1) had to support 3.5 people in 1979 compared to 2.1 in 1947 (2). Between 1960 and 1976 GDP grew at 5% p.a. and GDP/per capita by 2.7% (3).

This trend was recognised in the 1950s and 1960s; the limitations of agriculture as an employer, source of goods and finance led to an emphasis being placed on industry. The most intensive period of industrialisation was during the 1960s when planning was at it height. The dominance of industry in public investment for example, continued in the 1970s.

Continued high relative investment in industry did not cause faster growth rates in the 1970s for industry than in the 1960s. There was a step like increase in output after 1976 when foreign exchange increased in supply but, like agriculture (although to a lesser extent), it was a disappointment.

The 1970s did, however, bring new sources of foreign exchange including increased oil revenues, emigrant remittances, Suez Canal tolls and tourism. These funds created what might be called a parallel economy; they did not bring about changes in the domestic economy

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(1) One feddan equals 1.038 acres 0.42 hectares.

(2) K. Ikram op cit P3

(3) K. Ikram op cit P5, This figure was most probably bloated by growth of military spending and administration, as Mabro and Radwan claim it was in the period to 1973. Mabro & Radwan, op cit P44.



(industry and agriculture) to any great extent. They will be referred to as the 'Rental' sectors, because they depended on nature or on decisions made abroad.

They resulted from the liberalisation of emigration, political changes which enabled Egypt to re-open the Suez Canal and gain oil fields in the Sinai. Tourist revenues expanded as Egypt moved closer to the West and economy gained from higher oil prices in the late 1970s. The sources of wealth relied on the gifts of nature or foreign demand for Egyptian labour. Tourism relied on the growth of foreign income and demand, more than on Egyptian production in any sense.

These sectors were extremely successful in the later 1970s and provided the foreign currency to finance higher imports and consumption. As will be shown, they were not greatly used to change the domestic economy (industry and agriculture).

X Economic development in the second half of the twentieth century cannot proceed without government intervention. This view is derived from the work of Gershenkron (1). He suggested that, as an economic development took place during the nineteenth century, latecomers to the process had increasingly to protect themselves from existing industrialised nations. Thus, German industry developed with the involvement of banks, something which had not occurred in Britain. Later, Russian industrialisation began with government involvement which had not happened in either Britain or Germany. If that process of linking government and industry was necessary in the nineteenth century, then the need has increased in the twentieth as competition

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(1) A. Gershenkron 'Economic Backwardness in Historical Perspective' P353-9. Harvard University Press 1962.

on international markets has become more intensive and extensive. This has been recognised by writers with very different views (1).

There is an apparent paradox here. It seems that strong or effective government is needed, regardless of how interventionist the government policy is. This does not mean that the choice of policy is unimportant, but it does suggest that any policy will fail if it does not get adequate back-up. For example, a tax policy designed to finance educational programmes may be ineffective if the taxes cannot be collected (2). The aims of policy may become more modest or less interventionist but they will still fail without financial and other support. It is the nature of the relationship between government and the private sector as much as the relative strength of the two that is important. In this respect, important continuities in Egyptian economic experience will be noted in the 1960s and 1970s.

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(1) e.g. I. Little, I. Scitovsky & M. Scott's 'Industry and Trade in Some Developing Countries' P333. Oxford University Press 1970.

G. Myrdal 'The Challenge of World Poverty: A World Anti-Poverty Programme in Outline' P208-51, Vintage Books, Random House, 1971.

B. Balassa 'Policy Reform in Developing Countries' P87-97, Pergamon 1977.

(2) N. Kaldor 'Taxation for Economic Development', Journal of Modern African Studies, Vol.1, No.1, 1963.

## Chapter 2: The State

The state is defined here to include the President, the Cabinet, the Civil Service and all public sector administrative bodies. Throughout the period under discussion, it owned and controlled a large share of the nation's industry. The latter will be referred to as the Public Sector.

This set of institutions dominated Egypt's economic life in the 1970s as it did in the 1960s. In 1970/71 it employed 1.25m civil servants (1). Through this huge bureaucracy, it directly and indirectly controlled much of the economy and was directly responsible for producing an estimated 53% of GDP in 1971/2. (2).

In order to understand how policies were made it is, therefore, essential that the State be examined. There is another reason for its centrality in this thesis. The bureaucracy itself presented the President and Ministers with formidable problems. Between 1969/70 and 1978 the bureaucracy (civil servants in central government) grew by 74% to 2.07m (3). Management, control and funding of this body became a major preoccupation for economic decision makers.

Egypt's system of government was a Presidential one. This was true in the 1960s, but after 1970 Sadat accumulated more power in his hands than his predecessor had done in his final years. Sadat permitted no one else to remain in a position of influence for long and he gained prestige in the 1973 war, something which Nasser lost in the defeat of 1967 (4).

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(1) See Table 1 below.

(2) See Table 2 below.

(3) See Table 1 below.

(4) E. Ya'ari 'Sadat's Pyramid of Power', Jerusalem Quarterly, Winter 1980.

Although the Presidency employed 18,000 in 1978, it provided few technical skills to the President (1). He took his advice from Ministers and personal advisers on economic matters.

His powers were such that in 1970/71 he appointed 1,101 officials to the public sector and 725 to the civil service in order to ensure loyalty after the 1970 foiled coup attempt (2). This was equal to about 6% of senior and middle management posts.

The President was responsible for strategy and for any details which he cared to deal with. The way in which policy developed and was implemented from the President down can best be illustrated with an example. The October Working Paper was issued by the President in April 1974. It contained ideas which had been worked out by ministers over the preceeding six years. They advised him on what should go into the document. Ministers were chosen for their technical skills and political loyalty to the policies of the day. They were responsible for drawing up detailed plans to implement general strategy.

The first Deputy Prime Minister and later Prime Minister, Dr. A.A. Hegazi, drew up the 1974 Foreign Investment Law, number 43, after the October Working Paper was issued. He formulated it in consultation with ministerial colleagues (3)

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- (1) Data from 'Development of Employment in Government Administration'. Central Agency for Organisation and Administration 1965/66-1978. Comments based on interviews with Dr. A.A. Hegazi and Hatem Sadeq, former Official at the Presidency and son in law of President Nasser.
  - (2) M. Abdel Fadil 'The Political Economy of Nasserism' P96-101 op cit.
  - (3) Interview with Dr. A.A. Hegazi. See Chapter 3.

If the President can be identified as the source of economic strategy, then ministers were the main source of detailed policy. On all matters the latter were responsible to the President.

The three tiered decision making process - the President, the Cabinet and the bureaucracy - was not necessarily inappropriate. Abdel Fadil has suggested that responsibilities within the firm can be allocated in the following way (1). Senior management has responsibility for coordinating broad strategy, objectives, policies and functions. Middle management has responsibility for organisation, staffing and directing policies. Finally, the lowest tier should be concerned with detailed implementation. Each tier should be controlled from above, but senior managers should not spend most of their time controlling junior ones. They should oversee them and be responsive to outside influences and information.

This could be a description of how a government department should work and the difference between this ideal and the actual practice in Egypt will be analysed here.

Government administration did not work well for a number of reasons. Two of these concerned the senior tiers of the system:

1. Lack of coordination at the ministerial level.
2. High ministerial turnover and unwillingness to take decisions.

At the lower level, three problems dominated and these will be examined in the section below on bureaucracy.

1. Contradictory and often vague policy directives
2. Lack of authority and responsibility, unwillingness to take decisions.
3. Administrative problems resulting in slow and ineffective decision making.

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(1) M. Abdel Fadil 'The Political Economy of Nasserism' P101.

### Presidential and Ministerial Level of Decision Making

President Sadat was unwilling to delegate his powers to ministers for more than short periods because he feared that rivals to him might develop with their own power bases as they had done under Nasser. His experience under Nasser and in the 1970/71 purge convinced him of the dangers of 'centres of power' as he called them.

Despite the fact that the President had so much power, weak coordination and direction greatly reduced the effectiveness of his instructions. According to the Deputy Chairman of the Central Agency for Organisation and Administration, compilation of the 1972 state budget was hampered by the large number of central government bodies which had to be consulted. There was, he said, an 'almost total lack of communication' between them (1). No single body had the authority to impose its view and the President was the only person who could, at least in theory, cut through the bureaucratic maze. At that time, the President was unwilling to get involved in economic details.

The need for stable and competent advice at the highest level has been recognised. The former West German Finance Minister, Alex Moller, who was appointed a senior advisor to Sadat, recommended the formation of an advisory and planning unit at the Presidency to prepare guidelines for economic policy and to supervise their implementation (2). He presented his report in 1977, but by 1980 nothing is known to have happened concerning this recommendation.

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(1) The Egyptian Gazette 4.8.1972.

(2) A. Moller et al 'Proposals for the Solution of the Most Important Structural, Economic & Financial Problems of the Arab Republic of Egypt', 1980, German Development Institute, Berlin. P.6

Ministers knew that their very success might threaten their tenure if they became too popular as a result. Being associated with unpopular policies could work either way. They might be exploited in order to deflect unpopularity from the President or they might be sacked as scapegoats for policy failures. Dr. A.M. Kaissouni, who as a Deputy Prime Minister was responsible for the subsidy cuts which led to the January 1977 riots, had his resignation rejected by the President and reluctantly stayed in Government until 1978. Insofar as competent ministers were sacked and the administration disrupted, so efficiency was sacrificed to political convenience.

The complexity of the decision making process within and between ministries and other bodies meant that ministers spent much of their time dealing with details of administration rather than with policy and its implementation.

Vagueness and confusion of aims meant that other difficulties arose. The Deputy Chairman of the Foreign Investment Authority stated in 1977 that the 'Open Door Policy left itself open to a wide range of interpretations (1).

Ministers were often involved in interministerial conflicts which arose as vested interests inside and outside the governments clashed. Given their short periods in office, they were frequently unwilling to make unpopular decisions. Their junior officials passed a great deal of decision making up to them and so the volume of decision which they were supposed to deal with was considerable (2).

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(1) Mr. G. El Nazar interviewed in Al Ahram Al Iqtissadi 15.10.1977, Quoted by R. Driscoll et al 'Foreign Investment in Egypt' Fund for Multinational Management Education 1978, P.50.

(2) M. Berger 'Bureaucracy & Society in Modern Egypt', 1957, Pl61 Princeton University Press, Princeton, New Jersey.

The Foreign Investment Law resulted in applications from those interested in starting projects. These were dealt with by junior officials initially. In the heavily overstaffed bureaucracy, where officials had to justify their jobs by creating work, delays were the rule (1). Papers had to pass upwards on the most detailed subjects because junior officials lacked the authority to make decisions or when they had the authority, were unwilling to exercise it.

The US Government found major problems in this area while trying to implement its aid programmes. The planning of individual projects suffered from a lack of ministerial coordination. Ministries responsible for projects organised them without sufficient consultation with the Ministry of Planning and relied on the Ministry of Economy to supply the foreign exchange required (2)

The Ministry of Industry, traditionally responsible for the public sector, tended to represent its interests inside the government. The Ministry was founded during the phase of strong central planning in the early 1960s. The Ministry of Economy on the other hand was a product of the 1970s when the trend was towards liberalising the economy. It was responsible for encouraging the foreign sector and so came into conflict with the Ministry of Industry when firms operating under Law 43 threatened those in the Public Sector. The bureaucratic solution in 1978 was to give the General Organisation for Industry at the Ministry of Industry power to block foreign investment proposals.

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- (1) R. Driscoll et al 'Foreign Investment in Egypt', Fund for Multi-National Management Education, 1978 P50.
  - (2) Report of the US Controller General, 1977 'Egypt's Capacity to Absorb & Use Economic Assistance Effectively'.



Table 1: Shares of Public & Private Sector in GDP (%)  
1971/2 and 1979.

	1971/2		1979	
	Public	Private	Public	Private
Agriculture	2	98	3	97
Industry	69	31	61	39
Construction	92	8	74	26
Electricity	100	0	100	0
Transport	74	26	84	16
Housing	7	93	10	90
Utilities	100	0	100	0
Other Services	48	52	77	23
Trade	36	64	) ) ) 62	38
Finance	100	0		
Total Economy	53	47	57	43

Sources: 1971/72 - Ministry of Planning, December 1973 'Follow up and Appraisal for Year 1971/72'.

1979 - National Bank of Egypt 'Economic Bulletin', 1979 No.2  
T2 (Planned)

A number of ministers were appointed for the expertise which they could bring to government. They were known supporters of the current trend of policies being followed. As the move towards greater liberalisation went on, so new faces appeared in the Cabinet. Communists were in the Cabinet before the 1973 War but not after it. Those brought in for their skills often found that they, or the whole administration, faced political obstacles. Governments until 1975 were dismissed for failing to implement or support the economic liberalisation. After 1975 others were sacked for wanting to go too far in the direction of a liberal economy, something which was politically impossible for the President to permit. The very high turnover of ministers and governments which resulted from this is indicated in Table 2.

This reinforces the view that the government (i.e. the Cabinet and its most senior officials) was not responsible for economic policy, except in the short term. It looked to the President for direction and was permitted to interpret his wishes unless or until something went wrong. Given the weakness of the Presidency as a policy-making institution, the instructions given were usually badly specified. Abrupt changes in emphasis surprised ministers, as in 1980 when the President made a series of detailed economic announcements and sacked the Cabinet. (The details of this move are analysed in Appendix 2). The President responded to short term economic problems by changing policies or reshuffling ministers. After the 1977 riots, ministers were particularly unwilling to make difficult decisions. Ministers were like civil servants, in so far as they had relatively little leeway on major issues, always reporting to their superior. Yet they carried political responsibility and were sacked in a way which officials could not be. Dr. A.R.A Meguid was appointed

Deputy Prime Minister for Economic Affairs (as well as Minister for Finance, Economy and Planning) in 1980 after the President had announced changes in policies. The new economic supremo therefore had no chance to influence the decisions which he would have to implement. His opposition to the President's policies in 1980 was indicated in his attempts to cut subsidies about six months after the latter had increased them.

Table 2 shows that there were 16 government reshuffles in the nine and a half years from October 1970 to May 1980. Each administration lasted an average of 7.1/2 months therefore. Typically a Minister of Planning held office for 18 months and a Minister of Supply for just under a year in more than one government. Tenures of this length meant that serious administrative and political problems arose. Ministers took time to learn about their posts and to familiarise themselves with routines. As has been suggested, they lacked incentives to make difficult decisions. The system favoured short term rather than long term benefits; for example if a budget reduced inflation over the following six months then it would be more popular with the President than one which pushed prices up in the succeeding years. Economic gains were assessed according to political rather than structural or long term criteria. Major policy changes, such as Law 43 for the encouragement of foreign investment, were possible because they did not have any adverse short term effects on living standards or prices.

Finally, it should be noted that Table 2. only deals with some of the Ministries responsible for economic affairs. During the 1970s there were Ministries for Petroleum, Agriculture, Irrigation, Agrarian Affairs, Internal Trade, Transport, Power, Popular Development, Housing and New Communities. Also to be added are commissions, boards, organisations, administrations and agencies. Ayubi listed 1600 public authorities, 46 public organisations, 381 public companies, 6 independent bodies, 120 urban and 1000 rural councils (1). These were subject to constant reorganisation.

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(1) N. Ayubi 'Bureaucracy and Politics in Contemporary Egypt'. P234

Table 2: Changes in Ministerial Office Holders with Economic Responsibilities (i) 1970 - 74.

<u>Ministerial Post</u>	<u>Starting Date of Government or Reshuffle</u>							
	21.10.70	18.11.70	14.5.71	11.9.71	16.1.72	27.3.73	26.4.74	25.9.74.
Prime Minister	Fawzi	Fawzi	Fawzi	Fawzi	Sidqi	Sadat	Sadat	Hegazi
Deputy PM for Economic & Financial Affairs					Marziban	Hegazi	Hegazi	
Minister of Finance	Hegazi	Hegazi	Hegazi	Hegazi	Hegazi	Hegazi	Ibrahim	Ibrahim
Mister of Economy/ Foreign Trade	H.A Zaiki	Marziban	Marziban	Marziban		Hegazi	Madbuly	Amin
Minister of Planning	Gaballah	Gaballah	Sayid	Sayid	Sayid	Abdullah	Abdullah	Abdullah
Deputy PM for Industry & Petroleum		Sidqi	Sidqi	Sidqi				
Minister for Industry & Petroleum	Sidqi	Sidqi	Sidqi		Malla	Muhammadin	Muhammadin	Hasan
Minister of Supply/ Internal Trade	Marziban	Ashour	Marziban	Marziban	Mursi	Thabat	Maghrabi	Shadhilli

Table 2: Cont'd (ii) 1974 - 80

<u>Ministerial Post</u>	<u>Starting Date of Government or Reshuffle</u>							
	16.4.75.	20.3.76.	19.11.76.	2.7.77.	25.10.77	7.5.78.	4.10.78.	12.5.80
Prime Minister	Salem	Salem	Salem	Salem	Salem	Salem	Khalil	Sadat
Deputy PM for Economic & Financial Affairs			Kaissouni	Kaissouni	Kaissouni			Meguid
Minister of Finance	Ismail	Ismail	Hamid	Hamid	Hamid	Lutfi	Lutfi	Meguid
Minister of Economy	Shafei	Shafei	Sayegh	Sayegh	Sayegh	Sayegh	Sayegh	Meguid
Minister of Planning	Abdel Rahman	Al Imam	Al Imam	Al Imam	Kaissouni	Meguid	Meguid	Meguid
Deputy PM for Industry & Petroleum		Sultan	Sultan	Sultan	Sultan	Sultan		Hilal
Minister for Industry & Petroleum	Shahin	Shahin	Shahin	Shahin	Hilal	Hilal	Atalla	T. Zacki
Minister of Supply	Shazi	Fattah	Fattah	Fattah	Fattah	Tahoun	Tahoun	Nouh

Source: Arab Report & Record, various editions 1970 - 1980

### The Bureaucracy

The lowest tier in the government administration was the bureaucracy. It can be considered the decision blocking tier for two reasons. Firstly its size, growth and lack of skilled manpower made it extremely inefficient in the sense that decisions could not easily be implemented, their effects monitored and controlled. Secondly as a bureaucracy it was an organisation unsuited to change. Downs has made the point that as bureaucratic organisations grow, the capacity for effective action by top officials increases at a declining marginal rate. The amount of wasted activity increases. This is due, in part, to the increasing amount of time consumed in internal administration. Also according to Downs, the older such an organisation is the more likely it is to develop a self serving ideology (1).

These kinds of problems were implicitly recognised by Sadat. In the early 1970s he backed numerous reorganisations of the administration because as he said the government was in a state of internal 'chaos' and that he was losing 20% of his energy 'because of administration' (2). The central government administration went back to Pharonic times and maintained its central role whatever policies were followed (3). Nasser expanded it in order to provide jobs in the

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- (1) A. Downs 'Inside Bureaucracy' Chapter XXII, Little Brown & Co. 1967.
  - (2) N. Ayubi 'Bureaucracy and Politics in Contemporary Egypt' P500 Footnote 166.
  - (3) G. Baer 'Basic Factors affecting Social Structure, Tensions, Change in Modern Egypt' in Milson ed. 'Society and Political Structure in the Arab World', Humanities Press, New York, 1973, P3-4.

Table 3: Employment In Government 1969/70 - 1978.

Year	Number (000's)	Rate of Growth p.a. %	Share of Total Employment (%)
1969/70	1187.7	4.65	N.A
1970/71	1250.4	5.28	15.15
1971/72	1290.5	3.21	14.86
1973	1471.2	14.00	17.17
1974	1660.6	12.87	18.73
1975	1701.0	2.43	18.84
1976	1779.0	4.58	18.97
1977	1910.5	7.39	20.77
1978	2065.3	8.10	21.86

Source: Central Agency for Organisation and Administration:  
'Development of Employment in Government  
Administration' Information Centre Data Series  
 No.11, September, 1979.

N.B. 1975 & 1976 Estimates  
 1977 & 1978 Ministries of Justice, Defence, People's  
 Assembly and Central Auditing Agency  
 excluded.



Table 4: Estimates of the Increase in Government Employment by Educational Level, 1971/2 - 1980

	(1) Increase in Government Employment over Previous Year	(2) Number of Full Graduates from Universities (a)	(3) Implied Increase in Non-Graduate Employment if all Graduates to Government (b)	(4) = 3 if 50% of Graduates to Government
1971/72	40,100	31,634	8,466	24,283
1973	180,700	38,913	141,787	161,243
1974	189,300	42,295	147,005	168,152
1975	40,300	46,295	(c)	17,152
1976	78,000	55,430	22,570	50,285
1977	131,800	63,853	67,147	99,073
1978	154,800	56,471(d)	98,329	126,564
1979	N.A.			
1980	148,400			

Sources: (1) Table 3 above for 1971/2 - 1978. Data for 1980 from Ministry of Finance, Interview

(2) B.C. Sanijal et al 'University Education and the Labour Market in the Arab Republic of Egypt' Unesco 1982.

Notes: (a) Full Graduates = those who complete degrees and pass examination. Other graduates are those from non-University sectors and those who do not complete and/or pass all examinations.

(b) Assumes no delay between graduation and job application.

(c) Implies that some graduates took jobs elsewhere. According to the Undersecretary of State in the Ministry of Finance, interviewed in 1981, 21% of graduates took jobs outside the Government in 1976, 27% in 1978 and 36% in 1979. A figure of 45% was given for 1977 by the Central Agency for Organisation and Administration in 1981 (quoted in the Egyptian Gazette 8.3.81).

(d) 1978 Plus January 1979, discussed in text.

1960s to those who could not be absorbed elsewhere. University graduates were guaranteed jobs under the Employment Laws of the early 1960s but the trend has been to take on an ever increasing number of non-graduates. (See Table 4). In 1970 35,476 'graduates' were reported to have certificates 'not approved of'. All received government jobs under a system of 'intermediate certificates' (1). In the 1980/81 budget of July 1980 £E18 millions was allocated for accelerating the employment of graduates (2). At a minimum graduate wage of £E240 p.a. this would have permitted the employment of an extra 75,000 or 45,500 at higher graduate rate of pay. The term acceleration suggests that the budget may have included other items for such employment.

That an increasing number of unskilled workers were taken on is indicated by the fact that in 1974 the Deputy Prime Minister stated that 85% of Government employees had less than a university degree and that over half were either illiterate or only knew how to read and write. This compares with 73% below the university degree level in 1961 (3).

Table 4 shows that a much larger number of non-graduates (or "non-full graduates") than graduates were taken on from 1970/71 - 1978.

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- (1) Al Jumhuriya, 30.11.1970.
  - (2) Memorandum concerning the main features of the draft State General Budget of Fiscal Year, 1980/81 P4.
  - (3) L. Gullick & J.K. Pollock 'Government Reorganisation in the U.A.R.' (1962).

In 1973 the employment guarantee for graduates was made permanent by law. With the exception of medical students, university students two years after graduation and intermediate level students three years after graduation could apply for a government post as of right. The Ministry of Manpower checked requests from graduates and ministries plus government agencies. Funds were automatically allocated and this encouraged requests from state bodies which often exceeded supply(1). From 1973 to 1976 the employment guarantee was extended to military conscripts. The pressures which were severe in the late 1960s to provide more jobs for graduates and others, had not abated in the late 1970s even though the role of the state was supposed to be smaller in the more liberalised economy.

25,091 of the 56,471 university graduates of 1978 and January 1979 applied for public posts to the Ministry of Manpower in 1981. Of the 127,196 who graduated from vocational schools, 81,655 or 64% also applied to the Ministry to find them a job (2). These groups remained largely unemployed between their graduation and their allocation to public posts. Hansen and Radwan estimated them to be 200,000 a year in the 1970s (3).

The increasing share of employment taken up by the government was in part a result of the reduction in pressure (both legal and political) on public sector firms to take graduates.

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(1) B. Hansen & S. Radwan 'Employment Opportunities and Equity in Egypt' I.L.O.1982. P44-5.

(2) B. Hansen & S. Radwan op cit P53 footnote 7.

(3) B. Hansen & S. Radwan op cit P39.

As well as providing graduates and others with jobs the bureaucracy grew as a result of its own momentum. In 1968, according to Ayubi, the government needed 16,279 graduates, nearly 2,800 more than the number available. State organisations and senior officials wanted to increase their prestige and promotion possibilities by expanding their employment (1). From 1973 to 1977 total reported needs for graduates in shortage specialisations equalled 19,305 or 95% of applications. In surplus specialisations the over-supply was comparatively low, at 38% (2).

The administrative problems created by this employment inflation added to the difficulties inherent in the system. According to Waterbury, some parts of the bureaucracy behaved like private fiefdoms, ignoring directives from above and imposing their own decisions (3). Even the control agencies of the government, whose activities related to maintaining efficiency and accountability, suffered. The Central Auditing Agency had 72 officials at the level of Undersecretary of State (4).

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- (1) N. Ayubi 'Bureaucracy and Politics in Contemporary Egypt' P244-5.
  - (2) B. Hansen & S. Radwan 'Employment Opportunities and Equity in Egypt', op cit P207.
  - (3) J. Waterbury 'Egypt: The Wages of Dependency' in A.L Udowitch ed. 'The Middle East: Oil, Conflict & Hope' P332. Lexington University Press, 1976.
  - (4) N. Ayubi 'Bureaucratic Inflation & Administrative Inefficiency: The Deadlock in Egyptian Administration' Middle East Studies Vo.18 No. 3, July, 1980.

The solution put forward in the early 1970s was to try to improve the quality of administration and reorganise Ministries. A Ministry of Administrative Reform came into existence between 1974 and 1975 and a National Institute for Administrative Development was also created. Technical consultative offices were set up in the Presidency and Popular Councils were organised at local levels to decentralise decision making and increase public participation in economic activities (1). In an attack on the overcentralisation of government, the Ministry of Local Administration was one of those abolished (2). In 1970, the Finance Ministry was partially decentralised, a move which involved creating more posts for graduates. In 1971, the Ministry of Economy was reorganised and Higher Advisory Councils were created for economic affairs and trade. A general organisation was created inside the Ministry to control exports and 'verify imports against supply contracts' (3). The 1971/2 State Budget included the following points:

1. Employment allocations to be reduced to a minimum and new posts to be created only in urgent cases.
2. Redundant manpower was to be distributed after a thorough study of all posts in all sectors.
3. Privileges in kind would be revised and bonuses 'suppressed'.
4. Personal allowances would be abolished (4)

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(1) Presidential Decree No.2282 for 1971 quoted by N. Ayubi op cit, P310 and conversations with Dr. A.A. Hegazi.

(2) BBC/SWB 20.9.1971 ME/3793/A/2 2nd Series

(3) BBC/SWB 22.9.1971 ME/3793/A/1 2nd Series.

(4) BBC/SWB 21.9.1971 ME/3792/A/2 2nd Series.  
BBC/SWB 24.9.1971 ME/3795/A/2 2nd Series.

In October, 1971 the Ministry of Land Reclamation was renamed the Ministry of Land Reclamation and Agrarian Reform, with the General Authority for Agrarian Reform attached to it. What had been the Ministry of Agriculture and Agrarian Reform became the Ministry of Agriculture. The changes in agricultural control represented the continuance of a long struggle in the bureaucracy. The Housing Ministry was also reorganised in 1971. In 1974 the Ministry of Finance and Foreign Trade was replaced by separate Ministries of Finance and Foreign Trade.

This was a period in which the leadership felt that it could improve the functioning of the government and the economy by reforming existing structures, but these measures were also a sign of weakness. The ideology, according to Ayubi, was to introduce scientific methods into administration. In practice, reform involved partial, or marginal measures with none of the radical change that was needed. He stated that administrative reform contained ideological rationalisations, fights for areas of control, services and people, political participants and institutions, power drives, campaign strategies and obstructive tactics, compromise and concessions (1). It could not be isolated from reforms of the political process as a whole because its effects went beyond the administration to society as a whole.

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(1) N. Ayubi op cit P54 and P237-8.

In the early 1970s, attempts to reform the administration were frequent, but were carried out within an unchanged political and static economic situation. An essentially unreformed bureaucracy has hindered much private initiative since 1974, something which led to various types of activities and systems being chosen in attempts to circumvent the bureaucracy.

Below the Ministries were bodies responsible for controlling the Public Sector. Public Authorities were responsible for public services which were not necessarily profit making. Public Organisations were responsible for 'productive sectors' until they were abolished in 1975. They resembled holding companies and were replaced by weaker Higher Sector Councils. Their relationship to the firm and to the government is illustrated in Table 5 below.

### The Public Sector

Overstaffing and bureaucracy were present on a large scale in firms as well as in the government and the intermediate organisations. From the early 1960s publicly owned companies were obliged to take on graduates far in excess of their requirements. This policy was diluted from 1975 and officially ended in 1979 but the practice continued under government pressure (1).

According to the Chairman of the Misr Foreign Trade Company, in 1980, 50% of his 650 employees were under-employed. This he defined as the number who could be sacked without loss of output or sales by the Company. He has also said that within the foreign trading sector his company was in a relatively healthy position (2).

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(1) Financial Times 23.7.1980 Supplement on Egypt P.iv.

(2) Mr. W. Said, Interviewed.

A more scientific basis for estimating this over-employment is to see how many unskilled workers in ill-defined posts there were. According to the 1976 Census, a total of 559,900 were employed in the textile, clothing and leather sector. Of these 20,000 were government employees, 259,000 public sector workers and the rest, 270,900 worked in the private sector. Workers defined by skill totalled 64% of the public sector work force (165,760) and 92% (249,228) of the private sector (1).

This was the pattern in the paper, food and chemical sectors. Within Egypt, the public sector employed many more workers than equivalent companies abroad. The Abu Zaabal pharmaceutical complex was originally estimated to require 898 workers. In the first year of operation it employed 2,245 workers (2).

From 1961 until 1975 public sector firms were controlled by Public Organisations. They were responsible for most of the functions normally associated with a firm's management and were responsible to the Minister.

In 1971 an attempt was made in the law to reduce the powers of the Organisations and increase those of company managers. These measures did not, according to Waterbury, have any effect as they were not even implemented. In 1975 the Organisations were abolished (3).

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- (1) Census of Population 1972, Central Agency for Public Mobilisation and Statistics Cairo 1978 122.
  - (2) H. Handusa 'The Public Sector in Egyptian Industry 1952-1977' in 'The Egyptian Economy over Quarter of a Century 1952-1977' Studies and Discussions of the Third Annual Congress of Egyptian Economists 1978.
  - (3) J. Waterbury 'Egypt: Burdens of the Past/Options for the Future' P295. Indiana University Press 1978.



By 1979 there was discussion of the need to reintroduce the Public Organisations in order to increase the coordination of public sector activities, but nothing came of the idea. It is significant that coordination problems remained so severe that a return to the old system was even discussed (1).

From 1975 firms were grouped into sectors of similar and related activities. The Higher Councils performed a planning and coordination role for them. The latter, which replaced the Public Organisations, comprised the Chairmen of individual company boards plus officials from the Ministries of Planning, Economy and Finance. There were also outside experts. Councils were headed by Ministers and had the assistance of a technical secretariat.

Each firm had a general assembly which controlled its activities. The assembly also met under the chairmanship of a minister and had representatives of the Ministries listed above. It also had representatives of the Higher Council, the workers and outside experts.

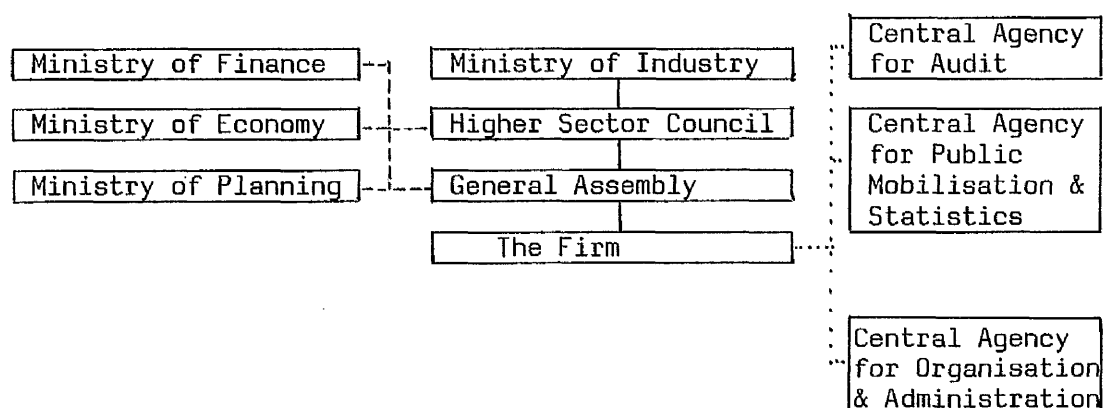
The Ministry of Finance which allocated production subsidies had a major influence on pricing, budgeting and investment. The Planning Ministry until 1980 set overall investment allocations, something which was done by the National Investment Bank after that date. The Ministry of Economy allocated foreign exchange.

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(1) N. Ayubi 'Bureaucratic Inflation and Administrative Inefficiency: The Deadlock in Egyptian Administration'. Middle East Studies, Volume 18, No.3. July 1980.

As well as all these institutional influences and systems the main Agencies of Central Government monitored the firm. The Central Audit Agency was responsible for checking financial results, the Central Agency for Public Mobilisation and Statistics collected and processed industrial data. The Central Agency for Organisation and Administration collected data on employment.

Table 5: Organisational Structure of the Public Sector



..... Monitoring Bodies  
 ----- Bodies supplying personnel  
 \_\_\_\_\_ Lines of Control

Source: Derived from A.D. Little Inc. An Assessment of Egypt's Industrial Sector,

1978 & N. Ayubi, 'Bureaucracy and Politics in Contemporary Egypt', P207-250.

NB: The lines of control indicated here are typical of the firms under the direction of the Ministry of Industry or about half of all public sector companies.

Finally the Central Agency for Organisation and Administration and Management supervised the implementation of labour laws.

Although the firm had to deal with numerous official bodies even after the 1975 reform, the most important control would often be a directive to fix prices. The implications of this for the financial position of firms and the performance of the economy as a whole are discussed in Chapter 4. From an institutional point of view such a directive could make the whole emphasis on decentralisation meaningless. None of the bodies described above had, under such circumstances, any influence comparable to that of the controlling ministry.

The 1975 reforms also forbade the sale of public firms to the private sector and blocked attempts to raise capital from the private sector. Firms totally owned by the state were to have the majority of their board members appointed by the Prime Minister with the rest being workers' representatives. This led to continued politicisation of the firm as well as instability. Directors were appointed often for political or personal reasons by the government and the high turnover of ministers led to a high turnover of directors.

The Board of Directors was given authority to draft the general plan for the firm as well as detailed production plans. It could also up-grade employees on the basis of their productivity. In 1975 the Cabinet decided that economic considerations were to be dominant in all matters relating to the public sector. This meant that decisions about prices as well as employment were supposed to have profitability as their main criterion.

The problems of bureaucracy and their perception by the President had a number of consequences. Firstly new institutions were sought which would operate outside the State's bureaucratic framework. As well as the Movement for Popular Development (1980), such bodies as the Arab International Bank (1970) were founded to attract foreign currency. It was permitted to operate without many of the restrictions imposed by law on existing public sector banks. This trend was not entirely new; the Suez Canal Authority and the Aswan High Dam Authority operated successfully before the move towards a more liberal economy began. They had been set up under Nasser's rule (1). Petroleum also operated outside the state sector with foreign investment.

The second trend was to avoid or minimise reforms of existing institutions with the exception of reorganising ministries. To the President, the civil service bureaucracy and the public sector were an inseparable mess. Guidelines for reforming the public sector came from Ministers rather than the President either because he did not want to face up to opposition directly or because he had no hope that reform could be achieved. Reform was not fundamental and the move towards decentralisation in pricing came to an abrupt end in 1980. The solution to the problem of industrial production was seen, at least by the President, in terms of creating a new, private sector with the help of foreign investment. This leads to the third trend in policy: the tendency to look abroad for the solution to economic problems in terms of aid as well as investment.

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(1) R.W. Baker 'Egypt's Uncertain Revolution under Nasser & Sadat' Harvard University Press, 1978.

The liberalisation programme outlined in the October Working Paper of April 1974 was vague. The main thrust of the programme was known beforehand: some of the most important liberalisation measures preceeded it. These are analysed in Chapter 3. Yet this was the main statement of a new era, following the supposed great victory of the 1973 war against Israel. With its criticisms of the public sector and its reassurances to public sector workers it did little to create a consensus on the need for reform. On this vital issue only this was said: the public sector was overly bureaucratic and the answer to the problem lay in 'further reorientation .... increasing progress (and getting rid of) obstructions and procedures which reduce its efficiency (1).

The meaning of this sentence had become apparent in Ministerial statements made from 1968 onwards. Yet by 1974 when the impetus for reform was at its peak and the government was about to introduce a radical foreign investment law, on this issue it was vague. In terms of action, less was done than was seen to be done. The abolition of the Public Organisations was opposed even by the Prime Minister of the 1974-5 period (2).

Finally, it should be noted that old 'remedies' were seldom completely abandoned. In 1980 the President announced that the powers of provincial governors would be increased at the expense of central government. This kind of reorganisation of the administration had achieved little in the early 1970s.

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(1) October Working Paper P58. English Edition, State Information Service, 1974, Cairo.

(2) Dr. A.A. Hegazi, Interview with

These characteristics of the decision making process conform in part to the ideas of Myrdal. His concept of the 'soft state' describes one in which social obligations such as paying taxes are weakly enforced, if at all (1).

### The Soft State

Egypt has had a long history of centralised administration but one in which the official, particularly at the local level, exercised power in a harsh, inefficient and often arbitrary way (2). Added to this was an experience of colonialism and rule by a foreign power through weak and nominally Egyptian government until 1952. These factors put many in a position of hostility to authority. From 1948 hostility was focused on Israel and this enemy became a rallying cry uniting the country and delaying domestic changes. The words of Nehru can be applied to modern Egypt when he said, in the Indian context, that a generation wed to opposing the colonialist regime became accustomed to opposing its own government after independence. The idea of continually trying to frustrate centralised government, or at least assisting its control did not die in 1952 (3).

These factors made it difficult to create and maintain social discipline. Another factor further reinforced this process: the revolutionary junta, which seized power in 1952, used the existing bureaucracy to govern. This continuity was in force as the regime's economic ideology became more socialist in the 1960s and more laissez faire in the 1970s.

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(1) G. Myrdal 'Asian Drama' Pantheon Random House 1968, P896.

(2) D. Landes 'Bankers and Pashas' Harvard University Press, Cambridge, Mass. 1953.

(3) Quoted in G. Myrdal op cit

The bureaucracy changed its composition over time but many officials adapted to very different ideologies. One important element of the continuity, which helped them maintain their position, was the dominant position of the State despite ideological changes.

This meant that those who had acted as agents of 'oppression' before 1952 became the agents of 'progress' and 'reform' afterwards.

A similar phenomenon applied in the 1970s as the same officials responsible for planning controls, sequestration and even imprisoning people under Nasser were supposed to implement reform under Sadat. This was not easy for them or the institutions in which they worked.

The most extreme form which a lack of social responsibility can take is corruption; Ayubi has chronicled a number of cases of corruption involving, among others, senior officials. Apart from the damage done directly by such activities the widespread perception of corruption in the late 1970s, created an atmosphere which was not conducive to economic development. What he called the 'civil culture' was weak in Egypt and in that environment informal relationships dominated (1).

Presidential concern about corruption and its socio-economic implications was expressed but action was very limited (2). As well as corruption there was the growth of a type of commercialism which has had adverse economic and social consequences. Much investment was concentrated in luxury housing development;

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(1) N. Ayubi 'Implementation Capability and Political Feasibility of the 'Open Door' Policy in Egypt' August 1980 Draft P74.

(2) President Sadat's speeches quoted in Arab Report and Record, 1 - 15 April 1975 and in BBC Summary of World Broadcasts, 9 September 1980.

this being particularly true of Arab funds used in Egypt. In Cairo, especially, a kind of enclave has been created within the economy consisting of luxury housing, hotels, tourist facilities and imported goods. These may or may not have spin-off effects on the economy as a whole, but they have had negative socio-economic effects. The visible disparity of wealth between the rich and the poor has grown since the liberalisation of the economy began; giving rise to social tensions. These were most dramatically manifested in the January 1977 riots. After then it was extremely difficult for the government to increase prices, even of such items as petrol, when the poor saw so much wealth about.

This kind of attitude reached its peak in plans to develop the Pyramids area at Giza, near Cairo, into a huge resort centre. The threat to one of the country's major archaeological sites was so great that popular opinion, as expressed in the Press, eventually forced the President to cancel the whole project.

Decisions made by government were not always dictated by the interest of the economy. Moore has chronicled the way in which the Ramses (later called the October 16th) bridge was promoted in Cairo (1). In 1961 a bridge over the Nile was planned to be built by a German firm but the deterioration in relationships with West Germany meant that the plan was dropped.

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(1) C.H. Moore 'Images of Development: Egyptian Engineers in Search of Industry' M.I.T. Press 1980. P185-7.



By the early 1970s Greater Cairo's Planning Commission had decided on other priorities. A number of builders and consultants, including Osman Ahmed Osman, head of the Arab Contractors Company, were pushing for the bridge to be built as part of a major road/flyover project in the city. A relative of one of the backers was put in charge of the Planning Commission and gained Cabinet permission for the bridge to be built. He then had the jurisdiction over the project taken away from the Commission, which was abolished in 1973. In 1973 the bridge was opened as part of a large road construction project.

Moore concludes that activities like this, on a huge scale throughout the economy, contributed to a collapse of the State(1). The networks of contacts which 'fixed' business deals and reduced government control to a shadow of what it was meant to be, was in Moore's view, beyond the President's power to clear up (2).

This was not a new problem. At the height of the planning phase in the early 1960s numerous problems arose. At that time there were failures of communication and coordination plus clashes over lines of authority between the Ministry of Industry and the National Planning Commission, the Treasury and the National Bank (3). Presidential participation in the planning process was limited. According to O'Brien, the planning process was far from optimal, with a failure to coordinate the choice of projects and the macro-economic relationships implied by the plan. Significantly there was no plan to supersede the

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(1) C.H. Moore 'Images of Development: Egyptian Engineers in Search of Industry', P205.

(2) C.H. Moore Ibid P206-7 Waterbury emphasises the fact that this system was also true under Nasser 'Wages of Dependency in the Middle East: Oil, Conflict and Hope' in A.L. Udowitch 'The Middle East: Oil, Conflict and Hope', Lexington University Press, 1976, P333.

(3) K. Wheelock 'Nasser's New Egypt: A Critical Analysis' P159-160

markets and price mechanism by alternative resource allocation methods (1).

The overall growth rate was a political decision imposed on the planners by the Presidential Council (2). He concluded that the First Five Year Plan suggested that all economic activity would be centrally planned but in practice the implementation of the Plan included 'no more than investment expenditure by the public and private sectors and the allocation of foreign exchange'. The formulation of the programme was neither highly centralised nor very scientific (3).

The experience of the 1960s is of direct relevance to an understanding of the policy making process in the 1970s. Egypt, even in its most centrally economic phase did not experience planning in the full sense of the word. The planning experience of the 1960s, favoured today by some in Egypt, was only a partial one.

In this sense there has been more continuity in economic policy than the announcement of an 'Open Door' would indicate. The weakness of economic policy coordination and formulation in the 1970s should not be related only to the more liberal programme adopted but also to something deeper in the nature and structure of the regime.

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(1) P. O'Brien 'The Revolution in Egypt's Economic System' P150.

(2) P. O'Brien op cit P157.

(3) P. O'Brien op cit P319

The failure of the supreme leadership to become involved in detailed economic policymaking contrasts with certain other countries in the developing world. During the late 1960s Pakistan's supreme economic body was the National Economic Council. Its Chairman was the President of the State and it consisted of representatives of central and local government at the highest political level. There was also an economic coordination committee at the ministerial level to ensure consistency in policies at the operational level.

According to Ibrahim, the involvement of the President was essential to the development process (1). In fact the President also chaired the Economic Coordination Committee. An executive committee of ministers dealt with project approval and all these bodies were superior to the Planning Commission.

At times there have been senior ministers with coordinating powers in the Cabinet responsible for economic matters. Dr. Sidqi had such responsibilities in industry, mining and petroleum as Deputy Prime Minister in the early 1970s. Dr. Hegazi as Deputy Prime Minister, first Deputy Prime Minister for Economic and Financial Affairs and Prime Minister from 1973 to 1975 had wide powers as Dr. Kaissouni and Dr. Meguid have had since then. Each of these senior ministers have been balanced to some extent by others inside the Cabinet, as well as outside. Dr. Sidqi was not responsible for Finance when he was in charge of Industry. Dr. Hegazi had more authority when

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(1) R. Ibrahim 'Administrative Obstacles to Development' in R. Robinson ed. Developing the Third World: The Experience of the 1960s', Cambridge University Press, 1971.

he was Deputy Prime Minister because there were no others of the same rank at that time. During the periods in which Dr. Kaissouni and Dr. Meguid were in power, the position of Dr. Hillal, Minister and more recently Deputy Prime Minister for Industry, was powerful. The Minister for Industry traditionally represented the Public Sector, often, although not always, against the policies of reformers in the Ministries of Finance and Economy.

One implication of this analysis is that the machinery used for making and implementing decisions in Egypt was inappropriate because it was inefficient. Much of the economic advice given to the Egyptian government has made this point, emphasising the need to move towards a more decentralised system (1). In view of Gershenkron's analysis, cited in Chapter 1, it seems that large scale intervention was inevitable in Egypt during the 1970s.

Nove has stated that one of the most serious problems in the Soviet economy (during the 1960s) was the inability of the centre to know what needed doing at the disaggregated level. Only through the bureaucratic hierarchy did the senior decision makers get their information (2). These were central contradictions in the system: the complexity of the economy was such that decisions could not be made efficiently in a bureaucratic way. It would seem that the stage of economic development determines the number and the complexity

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(1) e.g. Reports by Moller, Belassa, USA Government, IBRD and IMF (on the latter see Appendix 1)

(2) A. Nove 'The Soviet Economic System' P86 & P371.

of those decisions which need to be made. In the early stages of development the bureaucratic hierarchical model may be an effective instrument for decision making, planning and control. At this stage the number of decisions is small and their complexity limited (1). This kind of reasoning was used in Yugoslavia when decentralisation was implemented (2). Given that both the USSR and Yugoslavia were in the 1970s and 1980s much more developed than Egypt (in terms of GDP per head), it does not seem that the latter's administrative structure was inappropriate. The form which it took in Egypt was not ideal however. A centralised system may have been as efficient as any other but not as it existed in Egypt. It could have permitted the use of market forces but needed to avoid the excessive bureaucracy which even the USSR found a burden.

Given its mixed economy in 1970 Egypt left the public sector basically under bureaucratic control and developed a new sector based on private and foreign capital. The central government was left with the task of providing employment on a larger scale when one burden - that of employing more workers than required - was partially lifted from the public sector. This was the only major reform applied to the sector from 1975 which was not reversed by 1980. The economy had different sectors operating according to different rules. By the end of the decade they were not totally isolated from each other - the Law 43 sector was bidding skilled labour away from the public sector, as was emigration, so intensifying the squeeze on the latter. The public sector not only suffered from the bureaucratic control but also from

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(1) J. Tinbergen 'Economic Policy: Principles & Design' P201, North Holland Publishing House, 1964.

(2) D. Milencovitch 'Plan & Market in Yugoslav Economic Thought' P185.

competition, ironically from that sector with which it could not properly compete. It therefore sought to cooperate with the private sector under Law 43.

An important aspect of the relationship was that of rent seeking. The corruption which has been analysed represents attempts to make private gains (in terms of money, power, status and influence) as a result of controls and shortages. During the 1970s funds for paying bribes and bidding for licences increased. Given the need to find employment for thousands of graduates and others, the bureaucracy also grew. The area and incentives for interaction between the private sector and the bureaucracy therefore increased. Foreign investors and the Egyptian private sector sought permission for a much wider range of activities than were allowed in the 1960s. Their ability to fund rent seeking increased as the 'rental' sectors expanded. The bureaucrat's need to use his official position in order to make a private gain increased as the institution in which he operated grew and the chances of his attaining a well paid position shrank.

An attack on the bureaucracy and corruption by the President or Parliament was not possible because of the power of vested interests at work. The private sector could not provide alternative jobs for under-employed civil servants and public sector workers and so the bureaucratic problem grew in the 1970s.

Myrdal has provided a cultural or historical reason why officials in Asian countries were willing to take bribes or engage in other corrupt/extra-legal activities (1). Officials are willing to make a market for things which they would be less willing to in the West because of the legacy of pre-capitalist, traditional society. In the

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(1) G. Myrdal 'Asian Drama' P939-958.

latter, markets are disorganised or even non-existent. Personal connections are therefore vital if individuals want to get things done. Bribing an official is seen as an extension of the kind of behaviour which got things done in the village.

Public officials were badly paid in Egypt and therefore had an incentive to do what they could to increase their incomes. The legal means to do this were limited, but with increased funds in the economy from foreign aid, investment, oil and remittances the illegal and semi-illegal possibilities for gain grew.

The relatively small number of senior officials who could extract large gains had a vested interest in maintaining the large bureaucracy because they could sell a 'way through it'. This also applied to Ministers and others associated with the government. Junior officials who had less to 'sell' were protected by their seniors in that the latter helped to maintain their jobs.

### Chapter 3: The Origin and Development of the Open Door Policy

The form which the liberalisation of the economy took in the 1970s was, in part, a reflection of the development of the economy in the 1960s.

The early 1960s saw the effective nationalisation of most foreign and many privately owned Egyptian firms. Planning was instituted and large investments were made in heavy industry. The Soviet model was the inspiration for Egypt's first five year plan (1960-1965) and the USSR supplied aid plus expertise for its implementation. As in the USSR, agriculture was taxed to finance industry and emphasis was placed on heavy industry.

Planning was neither as centralised nor as comprehensive as in the USSR (1). In terms of implementation the plan was no more than an investment programme with the allocation of foreign exchange being carried out by the government. Targets other than investments were indicative (2). Provision was made for retaining a private sector in some areas, notably construction.

As well as planning the government had certain social, policy objectives which involved the introduction of subsidies on a small scale and a guarantee of jobs to graduates in the civil service and public sector. With a huge expansion of education, particularly at the university level, both the number of graduates and those looking for work rose (3).

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(1) P. O'Brien 'The Revolution in Egypt's Economic System P156-193.

(2) P. O'Brien op cit P319

(3) M. Abdel Fadil 'The Political Economy of Nasserism' P71-87.



The economy in the 1960s was, at least in theory, tightly controlled by the government through the central planning system. A Minister was responsible for each of the five main sectors of the economy: industry, trade, finance, communications and marketing. They exercised their responsibilities through public organisations, the latter being organised on a sectoral basis. Coordination was nominally carried out by the central planning system. A Ministry of Planning was set up in 1961 replacing all other planning bodies. The first year plan specified output targets in detail as well as the investment required to carry them out. According to O'Brien, the overall target of doubling national income between 1960 and 1970 was selected by the President, probably on a political rather than an economic basis (1).

The planning system, which involved extensive consultations with Ministries and other government bodies, did not work well because individual Ministries, often with Presidential backing, were able to get projects into the Plan which the Ministry of Planning did not believe could be funded. Hence the Five Year Plan became a collection of loosely drawn up investment projects. It had little influence on the sectoral plans drawn up by individual Ministries (2). O'Brien concluded that Egypt never experienced central planning in the sense of producing a detailed and integrated set of targets for the economy and enforcing adherence to them. Nor did the plan aim to supersede the market. It assumed that the market would continue to allocate raw materials, labour, intermediate and final production. The start of the Five Year Plan preceded most of the nationalisation. Egypt was left with a highly centralised structure with all the disadvantages and few of the advantages which that involved.

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(1) P. O'Brien 'The Revolution in Egypt's Economic System' P157.

(2) P. O'Brien op cit P159.

The second five year plan was never started. Hansen and Nashashibi stated that the men who pursued the first five year plan and its investment targets were not the same individuals as those who pushed Arab socialism with its effects on consumption (1). The implied lack of coordination and consensus within the government and leadership was dramatic.

The type of economy which Egypt adopted in the 1960s was closely related to her foreign relations, particularly her alliance with the USSR. The latter provided considerable economic and military aid. As Egypt became involved in an unsuccessful war in the Yemen and suffered defeat in the 1967 war against Israel, she became more reliant on the USSR. Her trade was largely with the Communist block and was based on a centrally controlled system of trade and payments agreements.

By 1968 Nasser was seeking assistance from the conservative oil-rich states of the Gulf. They disliked and feared his socialist orientation and interventionist foreign policy as exemplified in the Yemen War. In order to attract Arab aid, domestic and foreign policy reorientations were therefore necessary.

In 1968 two reforming ministers, Hassan Abbas Zacki and Abdel Aziz Hegazi were appointed to the Ministries of Economy and Finance respectively. They pushed for reforms of the foreign exchange system and the public sector. If subsidies were necessary then they should come from the Treasury and would be explicitly accounted for on grounds of social policy. Current revenues and expenditures should be

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(1) B. Hansen & K. Nashashibi 'Egypt: Foreign Trade Regimes & Economic Development', National Bureau for Economic Research, 1975, P127.

balanced and enterprises making losses would, according to Hegazi's plan, be closed down unless there was an explicit social policy reason for keeping them in operation. In the late 1960s the President began to speak about the need for 'scientific' management and favoured Hegazi's proposals because of his concern about industrial inefficiency (1).

This was a controversial matter and a sharp debate took place over the way in which public sector companies were to be run. Nasser came down in favour of a 'technocratic' approach but this did little to improve the environment in which industrial managers worked. They remained subject to tight political control and were watched over by the secret police and others. Baker states that they did not feel secure as long as the political left, which dominated the Arab Socialist Union (Egypt's only political party in the 1960s), regarded them as illegitimate (2).

By the end of the 1960s the economic balance sheet was mixed. Industry was almost completely under state control. Agriculture was indirectly controlled if not actually owned by the state.

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- (1) Documents of Abdoul Nasser, January 1967 - December 1968, Al Ahram Centre for Strategic Studies, Cairo. P377 and interviews with Dr. A.A. Hegazi, Finance Minister under Nasser and Mr. Hatem Sadeq, Nasser's son in law and former official at the Presidency.
- (2) R.W. Baker 'Egypt's Uncertain Revolution under Nasser & Sadat' P48-70, Harvard University Press, 1978.

According to Baker, the nationalisation of industry in 1960 and 1961 was carried out for political rather than economic reasons. As a result there was no central economic theory underlying the administrative arrangements in the economy (1). Hansen has suggested that while Nasser may have had socialist ambitions these were not shared by the army officers, civil servants and others who formed the establishment. They detested socialism and state intervention but gained from the expansion of the public sector (2).

Sadat inherited a public sector which was managed by an uncoordinated and ineffective system of control. Many of those who managed it were out of sympathy with what was supposed to be the ideology which governed the institutions in which they worked. There was a trend towards using the market to run the public sector but this only took the form of government announcements and not actual changes. The need to hold down prices and provide large numbers of jobs ran counter to the decentralising programme.

Dissatisfaction with economic structures reflected impatience with the lack of economic growth. As the economy virtually ceased to grow in the late 1960s, powerful groups could only get more at the expense of others. Some felt that the economic mechanism was hampering growth and latched on to the reforms in the hope of personal gain (3).

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(1) R.W. Baker op cit Pl76.

(2) B. Hansen 'Arab Socialism in Egypt', World Development, April 1975.

(3) M. Abdel Fadil, 'The Political Economy of Nasserism', Pl11-112.

The average annual rate of growth of GDP from 1960/1 to 1964/5 was 6.6%. Between 1965/6 and 1969/70 it was 4.3% (1). The latter was boosted by the growth in defence expenditure and administration (2). The growth of GDP was accompanied by a big increase in imports: From 16.5% of GDP, at factor cost, in 1960/1 to 24.0% in 1963/4 (3). As exports stagnated the deficit on foreign trade grew from 2.3% of GDP in 1960 to 10.1% in 1962 and 7.5% in 1963 when deflationary measures were introduced (4). These deficits were financed by aid from the USSR and, until 1965 from the USA. By 1969, aid received from abroad did not cover repayments and the effects of the Yemen War, population increase and the defeat in the 1967 War were all being felt. Between 1969 and 1972 non-military aid from the USSR was negative if repayments are included (5).

Achievements in investment and industrial output hinged on the availability of foreign exchange. In this crucial respect the Egyptian plans and the socialist philosophy which underlay them, differed from the Soviet model which inspired them. The other crucial difference lay in Egypt's inability to increase the domestic savings rate. O'Brien described the plans of the 1960s as vague in their explanation of this issue (6).

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(1) Calculated from R.Mabro & S. Radwan 'The Industrialisation of Egypt' P42.

(2) Mabro & Radwan op cit P44

(3) Mabro & Radwan op cit P193

(4) Calculated from International Financial Statistics, IMF, various Editions.

(5) Calculated from The Balance of Payments Yearbook, IMF, various Editions.

(6) P. O'Brien op cit P112-115.

In practice, savings, as a share of GDP fell, from 15.5% in 1955 to 12.7% in 1960, 13.9% in 1965 and 9.4% in 1970 (1).

Against a background of economic stagnation in the later 1960s President Nasser faced a choice. He could either try to intensify socialism and possibly move closer to the USSR or move towards a more market orientated economy. The choice was made in the latter direction in a very implicit way, without any announced alteration in official ideology. The first slight liberalisation moves came before the 1967 war but were intensified soon after, when some of those who were to serve as ministers under Sadat, were brought into office.

Nasser is sometimes considered to have left his successor with a socialist legacy but this is an inadequate description of the situation in 1970. There was state ownership and control of much of the economy plus fiscal arrangements for the poor but inequalities increased and the import of luxuries grew as soon as Sadat eased restrictions on them (2).

#### The Transition: Sadat's Early Years 1970-73

Sadat's most urgent task on being elected in 1970 was to secure his own power base. This eventually led to the arrest, trial and imprisonment, in 1971, of a number of his opponents, who had been prominent under Nasser. For at least his first six months in office, the President was therefore preoccupied with the struggle for power; other matters took second place.

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(1) Calculated from K. Ikram op cit P398-399

(2) R.W. Baker op cit & N. Ayubi 'Bureaucracy & Politics in Contemporary Egypt' P13-16.

Sadat's first government was formed in October, 1970. Headed by the elderly former diplomat, Mahmoud Fawzi, it was designed to appeal to all sections of the leadership. The Prime Minister, although not an economic specialist, favoured economic reforms. Other ministers were given the same posts that they had held under Nasser. Significantly, in the first government reshuffle under Sadat (November 1970) Aziz Sidqi was promoted from Minister to Deputy Prime Minister for Industry, Petroleum and Mines. This was done because of the nature of priorities facing the regime. Despite Nasser's acceptance, in 1970, of an American proposed ceasefire with Israel along the Suez Canal, pressure for war was dominant. After securing his own position, this was Sadat's second priority. In 1971 he made the following declaration:-

You expect me to speak to you today about the change and reorganisation of the state. However, that is not my aim at all. The aim we must never forget should always be that whatever we do, whether it is affecting change, reorganising the state, or anything else - anything we build - we must not forget that the aim should be the battle (1).

In January, 1972, Aziz Sidqi was appointed Prime Minister with the specific charge to prepare the country for war. There were a number of reasons for his appointment. Firstly, he had been responsible, to a great extent, for the industrialisation programme of the First Five Year Plan in the early 1960s and was considered to be an able and forceful technocrat administrator. He was loyal to the new

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(1) M.A. Sadat, quoted by BBC Summary of World Broadcasts (SWB) 18.9.71, 2nd Series ME/3790.

The phrase 'Reorganising the State' referred among other things to the reorganisation of ministries analysed in Chapter 2.

President and was close to the USSR and so could act as a link during this period of continued economic weakness in Egypt (1). He favoured reform of the existing economic structure, rather than changes in structures such as denationalisation, what was later mooted.

Although, under Sidqi's government, further reforms were announced, the emphasis of policy was less on economic change, than on preparing for war.

The President's power was limited during this period and his known preference for a more liberal economic approach was muted. It was hard to push measures which would permit greater freedom to import luxuries at such a time. In 1972 the Prime Minister announced a ban on imports of certain luxury goods and increased customs duties on others. Measures were proposed against the black market and shops selling smuggled foreign goods were closed. According to the then Minister of Supply, the President opposed the closure of these shops in Cairo's Shawarbi Street (2). It was a sign of the slowly developing economic liberalisation that, when merchants complained about the restrictions, their complaints were upheld (3).

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(1) The relationships with the USSR also affected Egypt's domestic political and economic choices at this time. Progress towards a more liberal economy could only come as opponents of the policy (and more generally those of the President) were removed from power. Although his main opponents had been imprisoned in 1971, the need to maintain good relations with the USSR, according to Rubenstein, meant that Sidqi was a logical appointee to the Premiership, despite his commitment to a controlled economy. (A.Z. Rubenstein, 'Red Star on the Nile' Princeton University Press 1977, P165. For similar reasons, Ismail Sabri Abdullah, a former communist, was appointed Deputy Minister of Planning in 1971. (op cit P150).

(2) Record of the Arab World 1972, Vo. 2 P1281.

(3) Al Ahram 3.10.1972 quoted in N. Ayubi 'Bureaucracy and Politics in Contemporary Egypt' P408-9.



There was a clear difference between Prime Minister Sidqi's statement that the selling of 'imported or smuggled foreign goods' was 'completely contrary to the need to transform our economy into a war economy' (1) and President Sadat's statement that with the liberalisation from 'foreign domination' and 'big capital', the state would sponsor private sector activity (2). These statements, made in the same year, reflect the differing policy objectives and orientations of the two men. The following year Sidqi was sacked.

### Inter-Arab Cooperation

The early 1970s were years in which Egypt moved closer to the oil rich Arab States. The death of Nasser and the more moderate approach of Sadat to the relations with such countries as Saudi Arabia facilitated this. On the governmental level, ministers such as Hegazi, worked to attract Arab finance.

Coming from small and often weak states, capital imports from Arab oil producers were not felt to be a threat to Egypt. The long experience of colonialism had made many wary of permitting foreign investment by Western firms. Arab oil funds were felt to be a safe alternative. The first stage in the liberalisation of foreign investment controls was in the direction of Arab investment and the government set up a General Authority for Arab Investment and Free Zones in 1971 (3).

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(1) See Note (2) previous page.

(2) Record of Arab World 1972 Vol 2 P1521.

(3) J.W. Salacuse 'Back of Contract: Implications of Peace and Openness for Egypt's Legal System' American Journal of Comparative Law, Vol. XXVIII, Spring 1980, No.2.

The most important economic project started at this time was the Suez-Mediterranean oil pipeline ('SUMED'), which was designed to bypass the then closed, Suez Canal. The project was a joint Egyptian-Arab one, in which Egypt's share of the capital was provided by the oil states. A West European loan, which the Egyptians originally hoped for, never materialised.

The main approach to inter-Arab cooperation was bilateral. The Egyptian-Kuwaiti Investment Company was created in order to fund projects in Egypt. Similar institutions were set up with the UAE, Saudi Arabia and Qatar after 1973. There was also a multinational approach with the Islamic Bank for Development, founded in Jeddah and the Arab Investment Company in Riyadh, in 1974. So far as Egypt was concerned, none of this would have been possible in the 1960s, because of the lack of a capital market and the weight of administrative restrictions. Arab investment became possible as a result of the gradual liberalisation of the economy, although most of it went into property development. It did help to reinforce and encourage the liberalisation process within Egypt. Sadat's relatively non-interventionist foreign policy and the greater market orientation in the foreign sector were much more attractive to the Gulf States than the policies followed by Nasser.

Another important aspect of the transition phase was the founding of a bank in Egypt with privileges unavailable to others at the time. Sadat wanted a bank to attract and deal with Arab funds, which would not suffer from the restrictions which prevailed in the rest of the economy, including the banking sector. The Egyptian International Bank for Foreign Trade and Development was set up under Dr. A.M. Kaissouni, the former Deputy Prime Minister for Economic Affairs under Nasser.

The Bank was to specialise in financing transactions between Egypt and the Arab States and would later attract emigrant remittances as well. Its capital was in free currency, as were its transactions. It was relieved of taxes, duties and employment controls which dominated elsewhere. Starting capital was provided by the Central Bank of Egypt and subscriptions were accepted from the Arab States. With their later involvement, its name was changed to the Arab International Bank (1).

These measures did little to alter the position of the economy: The size of capital inflows was small. They did help to create a feeling of movement towards a more open economic system. Egyptian emigrants were encouraged to remit funds home and changes in the exchange rate in 1972 resulted in an increase in remittances received through official channels in Egypt.

In March 1973, Sadat took over the Premiership himself. This was a move to centralise control over the levels of power and represented a move towards liberalisation in economic policy. At the same time as austerity measures were being introduced to prepare the country for war, Sadat was granted sweeping powers to increase taxation (2). The economic position, according to the President, had 'fallen below zero' (3), but the Deputy Premier for Finance and Economy was ordered to set up free trade zones and a bank to finance foreign trade (4).

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(1) Interview with Dr. A.A. Hegazi.

(2) A.Z. Rubinstein, 'Red Star over the Nile', P221-223

(3) M.A. Sadat, 'In Search of Identity', P245

(4) A.Z. Rubinstein, op cit, P223.

The President had backing from an important Parliamentary Committee for these moves (See Chapter 4). Their timing was significant: Important liberalisation moves were introduced only after the President had taken over as Premier. They were carried out as the country was being prepared for war; in December 1972 there had been student riots, partly as a result of the failure to go to war with Israel. As pressure and preparation for war intensified so did plans for economic reform.

#### Sadat's Political and Economic Conceptions

*gru blis* As well as the administrative and economic systems which he inherited from Nasser, Sadat also inherited a country deeply affected by political terror. The extensive use of secret police forces and even concentration camps, backed up Nasser's regime. Baker has pointed out that many industrial managers were afraid to take initiatives in such a system and that most simply awaited orders from above (1).

In a society with so much power concentrated in the hands of the President, it is essential to examine his ideas and conceptions. In seeing what he reacted against, it is possible to understand the direction in which he was trying to move. In the political sphere, changes came quickly, but with regard to economics, change was much slower. There were several reasons for this. Political and legal changes were a precondition for economic change. Liberalising the economy would involve alterations in the balance of economic power at

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(1) R.W. Baker 'Egypt's Uncertain Revolution Under Nasser and Sadat' P183.

a time (prior to 1973) when the President's position was circumscribed. Finally, a change in the country's international orientation was needed; Egypt could not import Western capital and technology and de-centralise her economy while being closely tied to the USSR. Somehow she had to move towards the West. The outcome of the 1973 War made such a reorientation possible.

Sadat emphasised the contrast between a 'state of institutions', which he wanted to create and the 'centres of power', which he inherited. The former would wed institutions to the rule of law. Four institutions were envisaged. The first was the executive, the second was parliament, the role and influence of which increased under Sadat. Thirdly there was the Press, which was freed of many restrictions and finally the ASU. The role of the latter declined until it was later abolished. In Sadat's view it consisted of a series of cliques which exercised their power through secret police forces. It had, he believed, made Nasser and Egypt a prisoner.

Among Sadat's first measures were moves towards desequestration at the end of 1970 (1).

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(1) The Economist, 2.1.1971.

### Constitutional Reform

The process of reform culminated in the introduction of a new constitution in September 1971. It was approved by a referendum. Of economic significance were the following clauses in the constitution:-

Article 32: Private Ownership is embodied in non-exploiting capital. Its social functions are governed by law to serve the national economy.

Article 33: State ownership has its sanctity. Its protection and consolidation is a duty of all citizens, since it is the basis of the socialist system and the source of popular welfare.

Article 34: Private ownership is safeguarded. It cannot be brought under sequestration, except in cases stipulated by law and by court order. Expropriation is only to be effected for public interest and in return for the legally stipulated compensation.

Article 35: Nationalisation can only be effected for the public interest within the law and in return for compensation.

Article 52: Citizens have the right to permanent or temporary emigration abroad. The law governs emigration procedures.

Article 57: Any aggression on personal liberty and the private lives of citizens as well as any aggression on the other rights and public liberties would be a crime. The state is to provide adequate compensation to the victims of such aggression.

These clauses were highly significant. Numbers 32 and 33 were in the spirit of Egypt's socialist orientation. The others listed above were directed towards reassuring people after the era of police power.

The latter was essential if the public was to have confidence in the state. The clause dealing with emigration was, in 1971, theoretical, because exit visas still had to be obtained from the authorities. However, in a society as closed as Egypt was in 1970-71, this was a significant indication of the government's desire to liberalise the country. These legal changes were a precondition for the changes in attitude which might lead to economic improvements.

The October Working Paper, issued in April 1974, was named after the 1973 war, which, as far as Sadat was concerned, marked the 'liberation' of Egypt in a number of ways. It removed the stain of defeat which had prevailed since 1967 and, in so doing, had ended much of the pressure for further military action, even though territorial achievements in the 1973 war were limited. The war moved Egypt towards the West.

The Working Paper contained many ideas which had been formulated by the economic liberalisers since 1968. It was written in a very personal style and was far from being a scientific representation of set ideas. It was issued in the President's, rather than the Government's name.

One of the most significant aspects of the Paper and of Sadat's speeches in 1974, was the discussion of the economic cost of war. Sacred political causes seldom have monetary costs, according to those who favour them, and so the mention of these costs suggest a growing influence of technocrats concerned with economic improvements. They were more interested in economic, rather than military, objectives. The President's statements reflected their views, (or reflected some of his own thinking), which he had suppressed before the 1973 War. The

feeling that war was a burden and even an unnecessary one, from Egypt's point of view, made possible the disengagement agreements in 1974 and 1975 with Israel. These brought tangible economic benefits in terms of oil fields recovered in the Sinai and the possibility of reopening the Suez Canal. Yet this was apparently only possible after the recovery of national self-respect following the crossing of the Suez Canal by Egyptian troops in October 1973.

In pointing the way ahead, the Working Paper recognised the inevitability of socialism, but asserted the need for Western technology and capital to accelerate development (1). Emigration would be encouraged in order to reduce the excess amount of labour on the domestic market. The public sector would be committed to plans formulated by the state, but the private sector would only be influenced by indirect methods, such as taxes, credits, incentives and other government measures (2).

The President's frequently stated aim was to get the private sector to provide about 30% of GDP. His model was Austria (3). A mixed economy would imply a reduced role for the state and, in asserting this, Sadat implicitly rejected the atheistic paternalism of Nasser's era. He saw Egypt as a family under God with the President as a father figure. Disagreements were permitted; the state and its security

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- (1) The October Working Paper. April 1974, State Information Service Ministry of Information, Cairo, P65 (English Version)
  - (2) The October Working Paper, op cit P88.
  - (3) M.A. Sadat, Interviews on 9.3.1976 and 4.6.1976 in Speeches and Interviews of President M.A. Sadat ('Speeches') January-June 1976, P198 and P671.



police would not dominate people's lives. Criticism would, however, remain constrained. The dignity, religious devotion and tranquillity of the village were contrasted with the materialism and relative atheism of urban life. Although Sadat's policies encouraged a materialism which was to become sharper than in Nasser's era, at the heart of the economic philosophy was an attempt to make use of private initiative:

"The state cannot do everything for them and the error we committed in the application of our past socialism of idols was that the state used to do everything for the individual, thus he became used to not benefiting from his own capacities and talents ... There must be a personal incentive for reconstruction"(1).

The idols referred to were the Soviet Union and its allies. A profound mistrust of the USSR in political terms and a feeling that its economic system was not relevant in Egypt, characterised Sadat's thinking. Sadat, like Nasser in the latter's last years, favoured the application of 'science'. This can best be interpreted as the application of technology and incentive. Sadat also stressed the importance of 'faith', a value which he associated with the stability of village life; one which reinforced the family and the status quo in political terms.

This did not mean that the President would shed his powers, but power would be used more liberally and the President would concern himself with strategy rather than details. This would remove the 'hatred' which dominated Egyptian life in Nasser's last years and formed, according to Sadat, the worst part of the legacy which he inherited (2).

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(1) Speeches July - December, 1977, P252, Speech made on 26.9.1977.

(2) Egyptian Gazette, Cairo, 21 and 24 August, 1973.

The President laid down an implicit framework for economic policy. The private sector would be allowed to expand to about 30% of the economy, socialism in terms of a large public sector would continue, as would social welfare policies. Few details were spelt out, however. Austria was often mentioned, not only because of its mixed economy, but also because of its prosperity. The details of how this socialism of prosperity were to be implemented would be worked out by the government and not the President. This lack of Presidential attention to economic detail was to prove a major problem, one connected to the structure of the state and the way it operated.

#### The Impact of the 1973 War

The 1973 War had both political and economic seeds. On the political level, Egypt's aim was to recover Arab land lost in 1967 and to somehow solve the Palestinian issue. More immediately, she wanted to recover the Sinai, thus enabling her to re-open the Suez Canal without the humiliation of having the Israelis on the East Bank. Sadat's strategy was one of limited war; if his armies were unable to move all the way across the Sinai, he would at least be able to focus international attention on the issue of Israeli occupation of Arab land. He hoped to secure American assistance in pressuring Israel to withdraw.

He chose to fight, as it became apparent that the USA, with or without the USSR, would not force Israel to withdraw to the 5 June 1967 borders. Indeed, in 1972-73, the international situation looked to be moving in the opposite direction, as the Superpowers engaged in detente.

The War achieved one of Sadat's main aims: to involve the USA in active diplomacy in the Middle East. By acting as the intermediary between Israel and Egypt, the US came to have a new interest in the region. As well as supporting Israel, it gained or created an interest in the disengagement agreements themselves. It therefore had an interest in supporting a regime in Egypt which would negotiate such agreements and maintain them. To the West, Sadat gave an impression of moderation, because he was willing to gradually disengage from the conflict with Israel.

The negotiation and the extensive nature of the second Egypt-Israel disengagement agreement led to a break with Syria. This, in turn, caused a worsening of relations with the Arab Oil States, which feared Baathist (Syrian) and other radicalism, and disliked Sadat's way of dealing with Israel. An element of tension entered into the relationship between Egypt and the Arab oil States soon after a War which had done so much for Arab unity. The period of Arab unity and bilateral cooperation faltered after 1975.

Despite this, Egyptian economic policy aimed at attracting oil funds, then increasing at an enormous rate. Some of those who drafted the 1974 Foreign Investment Law (No.43) felt that the most important source of funds under the Law would be Arab, rather than Western (1).

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(1) Interview with Dr. A.A. Hegazi.

Oil funds did come to Egypt, but many came in the form of expenditure by individuals in Cairo. This type of spending, particularly on luxury housing, entertainment and tourism, caused inflation: The price of land and apartments began to increase more sharply. This opulence was resented by many in Cairo, struggling on much lower incomes. Perceived inequalities contributed to the tensions which exploded in the riots of January, 1977. Ironically, this very problem made it easier for Sadat to adopt a policy much more along the lines of 'Egypt first' than previously.

Victory in the 1973 War, defined largely in terms of the successful crossing of the Suez Canal, increased Sadat's domestic prestige considerably. He was able to become much more explicit about the economic policies which he favoured and pushed for more radical and faster reform. Victory also gave him the security to make the disengagement agreements, despite opposition in the Arab World. The reopening of the Suez Canal on 5 June 1975, not a condition of the Disengagement Agreement with Israel. It was typical of the type of independence found in the political sphere which could be transferred into concrete economic change.

President Sadat had, until 1973, lived under the shadow of Nasser's memory. The War made him victorious in Egypt and a figure of importance abroad. He gained stature and the power of initiative at home for the first time.

The period from 1973 can be seen as marking a major increase in presidential power, with importance consequences for economic policy. The War was Egypt's first military success since the 1952 revolution.

Nasser ruled over a coalition of interests and pressures, which he never fully dominated (1). His own failings led to a lack of strategy. The 1967 defeat forced him into directions possibly against his own preferences. Egypt's leadership, as suggested in the first chapter, was in a state of internal disarray in Nasser's later years. When Sadat took over, the disagreements about political and economic policy continued. Even after ousting the leftist group under Ali Sabry, Sadat could not openly declare his domestic aims. The War made it possible for him to be more explicit. He no longer needed the support of those who favoured a pro-Soviet course, or even those who wanted to restrict the liberalisation of the economy. His first choice of Prime Minister after the War, Abdel Aziz Hegazi, did, however, represent continuity. The economy remained in a dangerous condition; the War had not been costless and the problems which preceded it did not disappear. Cautious technocrats were needed in order to introduce the Open Door. Those who had served from 1968-74 would be useful because they could not easily be accused of betraying the nation's socialist legacy.

Hegazi's government was sacked in April 1975 after only seven months in power. This was the political end for those who had served under Nasser.

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(1) R. Springbord, 'Patrimonialism and Policy Making in Egypt: Nasser and Sadat and the Tenure System for Reclaimed Lands' Middle East Studies, January 1979 and P.J. Vatikiotis 'Nasser and his Generation', Croom Helm 1978.

Dr. Sidqi's removal from the Premiership in 1972 represented a move in this trend, but could only be done in the name of preparation for war; something of greater importance than domestic political issues. Hegazi was removed in order to change the pace of economic events and the emphasis of economic policy (1). The policy was very much the President's despite its origins under Nasser; the speed of implementation was even more a question for Presidential initiative.

1974 brought the introduction of the Foreign Investment Law no.43, which offered foreign investors tax holidays and exemptions from many of the restrictions applied to domestic firms. The General Authority for Arab Investment and Free Zones became the General Authority for Arab and Foreign Investment and Free Zones.

In 1977 the Law was amended so that its benefits would be available to Egyptians. By this time there was a growing disillusion with the possibility of large scale Arab investment. As a result the word 'Arab' was dropped from the Investment Authority's name.

1977 also saw riots as subsidies were cut and a number of basic commodities rose in price. The threat posed to social stability by the lack of these goods and services became an acute policy problem. In the years after 1977 it was observed that neither the public sector nor domestic, foreign (joint venture) activity was solving the problem. Coupled with the need to improve the marketing of foodstuffs, a new approach was evolved. In 1980 this had coalesced into the Movement for Popular Development.

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(1) 'Here I would like to say a few words about the recent Cabinet reshuffle. It did not occur because Dr. Hegazi had done wrong in any respect (but) because I saw that the pace of the Open Door Policy was not as quick as it should be' President Sadat, Speech 20.4.75 (Speeches January - June 1975 P232).

### Non-Governmental and Semi-Governmental Approaches

Within the framework of the National Democratic Party (NDP) a new initiative was taken in order to increase the production and improve the distribution of basic goods and services. This was the Movement for Popular Development founded in 1980. Its aim was to encourage Egyptian private sector activity in food production, land reclamation, housing and agriculture products marketing. Its head was Osman Ahmed Osman, Chairman of the President, former Minister and Head of the engineers syndicate. As Deputy Premier for Popular Development he aimed to increase private investment in the 'New Lands' which had been reclaimed from the desert and in good storage projects. The Organisation was to be staffed by as small a bureaucracy as possible with experts being hired as consultants from the private sector and abroad. Osman stated that the Party had to take the lead in investment encouragement (1).

There are two aspects of this development which are relevant to the analysis of economic policymaking. The first is that the Movement for Popular Development represented, in somewhat vague terms, an attempt to extend the 'Open Door' inside the economy. There was considerable disappointment over the level and type of foreign investment under Law 43. There has also been concern about the overall pattern of investment, both of the public and private sectors in meeting food and other basic needs.

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(1) The Egyptian Gazette, 8 March 1981.

The public sector was seen as incapable of dealing with the problems because it was overloaded with bureaucracy; reasons given for the whole movement towards liberalisation in the 1970s. The private sector was felt to lack experience, finance, contacts and the infrastructure to deal with the problems but was thought to have the power of initiative (1).

The second aspect was the administrative one. Originally the popular development movement existed outside the government. Then with Osman's appointment as Deputy Prime Minister it moved inside the government; at least formally. Early in 1981, with his resignation from the Deputy Premiership it appeared to lose some of its government status. This points to organisational or administrative vagueness. Lines of authority were often unclear and were frequently changed. The fact that the Organisation and the Movement which it was started to direct were outside the government was not necessarily a problem as the aim was decentralisation. The changes in the organisation resulted in uncertainty; something which constrained activity.

At the time of writing it is not clear whether the Movement for Popular Development is anything more than a framework or a slogan. It was a reaction against perceived failures in the Open Door Policy and it was significant that it was only started after the opening to foreign capital. If it is as revolutionary a concept as its supporters declared, then it may have been what Egypt needed much earlier in the 1970s.

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(1) Based on an interview with Mr.N. Dief, Consultant to the Popular Development Organisation and former Treasury Minister.



#### Chapter 4: Planning and Investment. Introduction

This Chapter will examine the principal methods used for developing and controlling the economy. In the 1970s these consisted of plans for the public sector, plan frameworks for the private sector and a move towards greater use of market forces. The latter was concentrated on the foreign sector which is analysed in a separate chapter. Some liberalisation moves affected the domestic economy and these will be examined in Chapter 5, along with the effects of planning on public sector performance.

The relationship between planning in the 1960s and 1970s is of particular interest because it helps to show how economic thinking, institutions and even performance changed.

In the 1970s annual and five year plans were issued. These gave targets for overall and sectoral growth. All private sector firms, in consultation with the government were issued with annual targets for production and investment which were supposed to fit into the overall framework. Specific targets were issued and highlighted as urgent objectives by the government; housing was a notable example in the 1978-82 plan.

The nature of the plans was a function of their origin. They came from the Ministry of Planning after consultation with other government department, but the Ministry lacked the power to coordinate and enforce them. If politically powerful groups overspent or went beyond the plan, then the Ministry of Planning could not bring them back into line. This affected the methodology of the planning process. Material balances were used to try to ensure consistency of targets in the planning process but the final

version of the plan was usually a compromise of political, economic and institutional pressures. The plan was seldom as consistent as the planners would have liked.

Targets issued in the 1970s were not exhortatory except in a mild sense. Although they were often not met, they were not completely unrealistic and did not require the kind of Herculean efforts that the Soviet plans did in the 1930s. An exhortatory planning system would have required a major effort by the leadership to focus attention and efforts on economic objectives. Given the disillusion with planning in the 1960s described in Chapter 3 and the moves towards a more liberal economy, the President and the government were not willing to play that role.

Another major problem with the system was the lack of a mechanism, either formal or informal, to enforce the plans at the level of the firm. This would have been necessary even if the political leadership had been involved in the manner described above. As it was not so, the need to motivate managers and other key personnel was even greater. Key personnel did not receive production bonuses and so their remuneration was not directly related to meeting plan targets. The complicated problems which they faced in trying to generate profit in the public sector are examined in Chapter 5. Given these, direct incentives to overcome difficulties were needed. In fact bonuses were laid down by the state according to status in the firm. Profit sharing benefited all employees in profitable firms but profits, as Chapter 5 shows, were something of a residual over which managers had little control. Wages were set by the government, sometimes with Presidential intervention and were unrelated to productivity changes.

The remuneration system therefore provided incentives to maintain the status quo. Managers and employees were guaranteed payments, even if they were low and largely unrelated to their own efforts. In the highly bureaucratic system no one was given a strong incentive to push for new solutions or to use their own initiative in more than a narrow way.

Further problems are highlighted by a comparison with the Soviet planning system as it existed up to 1960. According to Nove, the Soviet system had two key features (1). The first was the use of material balances which ensured that the inputs of one industry or firm were balanced by outputs from another. Planning was done in physical units and covered the whole economy. At least in theory, every output and input was accounted for even if continuous changes in targets had to be announced. The system was therefore theoretically consistent; it did not rely on inputs which were not produced and did not involve outputs which were not sold. While many mistakes were made and imbalances were generated between supply and demand, the economy grew at an overall growth rate which generally satisfied the planners and their political masters.

The second feature was the simultaneous planning of inputs, outputs, investment and finance. The latter was totally domestic, except for a small number of trade credits to cover imports of technology. The USSR was therefore self sufficient almost entirely and its foreign trade was planned.

Lange has specified some additional factors which are needed for planned development in a country such as Egypt (2). These include

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(1) A. Nove 'The Soviet Economy' P79-97, George Allen & Unwin, 1961.

(2) O. Lange 'Economic Development, Planning and International Cooperation' Central Bank of Egypt, 1961.

investment in agriculture in order to feed growing urban population, balance between inputs and outputs and monetary balance. By this he meant that there should be enough goods and services available to meet demand generated by incomes earned. If a balance of payments deficit occurs, then capital imports need to be planned.

Egypt, in contrast, did not plan the whole economy. The foreign sector was subject to controls but was not fully planned. Yet the plans themselves relied on imported goods and services to a large extent and the low level of domestic savings meant that they relied on external finance as well.

Given the much greater reliance on the foreign sector in Egypt than in the USSR for example, the lack of planning in that field was a serious weakness. Related to this was the lack of financial planning. The extent of deficit financing which resulted, its nature and consequences are analysed in Chapter 6.

Egypt faced a series of choices in the 1970s. She could try to liberalise the whole economy or maintain the division between the public and private sector. Given the latter choice, she could maintain close control over the public sector or liberalise it while retaining state ownership and some controls. In the face of constraints which are examined below, reforms were limited. The plans under which the public sector was supposed to operate were partial, concentrated on investment and failed to provide inputs in all cases. Yet the system was rigid enough to prevent the emergence of any informal mechanism which could balance supply and demand, except for the black market which did not solve the problem more than partially (1).

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(1) See Chapter 5.

### The Planning Machinery

Many ministries, authorities, agencies and departments were involved in the planning process, as can be seen in Table 1. The Ministry of Planning was formally in charge of coordinating plans and investment throughout the economy. The plans, which mainly consisted of lists of investment projects, were generated by the various ministries controlling different sectors. The Ministry of Industry, through its General Organisation for Industrialisation, controlled, under the 1978-82 plan, 32% of public sector investment. The Housing and Reconstruction Ministry was responsible for 14.6% (mainly the cement industry), Military production for 6.2% and Supply for 2.4%. The latter controlled what were referred to as 'strategic' goods such as bread and cheap cloth. The rest was controlled by a range of other ministries and bodies.

The Ministry of Planning obtained lists of project proposals and adjusted them by persuasion, negotiations and exclusion to fit an investment budget determined from a macro-economic model (1). The plan then went to the Cabinet and the President for approval. Individual projects were not subject to a full social and economic evaluation, they simply passed through the bureaucracy in ways shown below (2). Investment was not therefore determined by an overall plan, it was simply amalgamated into five year programmes. If a particular project did not get into the five year plan then it might get into the annual plan and budget.

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(1) A.D. Little Inc. 'An Assessment of Egypt's Industrial Sector', P35-37, January 1978.

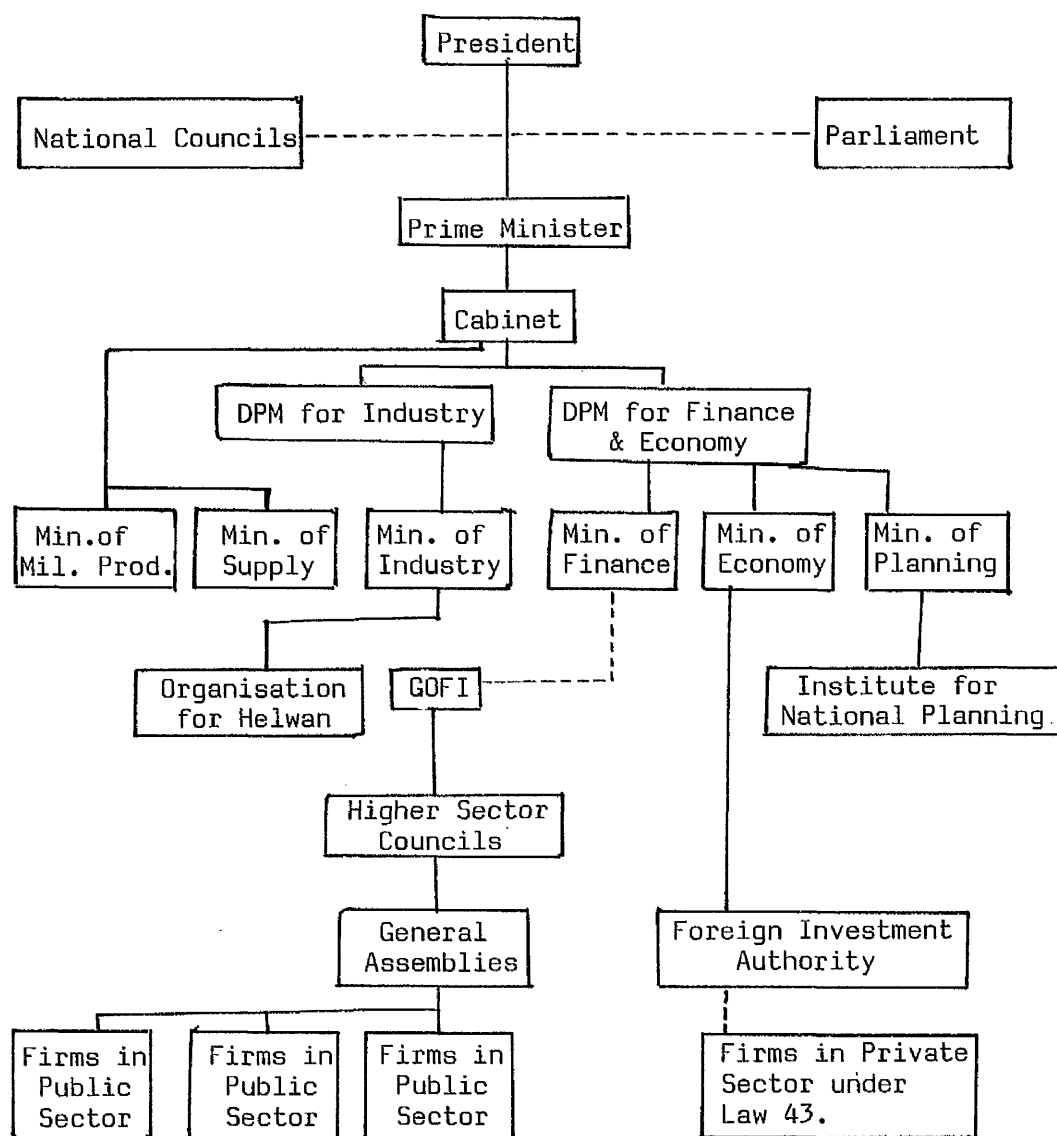
(2) A.D. Little Inc. op cit P42.

This was quite different from the Soviet system because of the lack of a mechanism for ensuring consistency. The Ministry of Planning in Egypt lacked the power or ability to balance inputs and outputs of different sectors or firms. There was no system for continuously recalculating the plan and its targets so as to improve the match of inputs and outputs at the micro-economic level. Rolling targets and plans meant a political or bureaucratic rewriting of overall objectives rather than a technical or economic re-examination. The plans and targets of the second half of the decade stressed immediate needs for food and basic commodities by re-allocating investment rather than by changing the mechanism which balance supply and demand.

Table 1: Major Bodies Involved in Planning, 1975-80 (1)

\_\_\_\_\_ Main Lines of Authority

----- Indirect Lines of Authority.



Note: 1. In 1980 the National Investment Bank took over the Finance Ministry's investment budget functions.

Source: Developed from 'A Strategy Study of the Egyptian Metallurgical Industry' Phase I Report, Atkins Planning Ltd in A.D. Little Inc. 'An Assessment of Egypt's Industrial Sector' January 1978 Appendix B, P1-3. and A. Ayubi 'Bureaucracy and Politics in Contemporary Egypt' P230-237.

## Procedures:

### The Flow of Decisions in the Public Sector

From the viewpoint of the firm a number of decisions were very important. These related to new projects, the annual capital budget and the annual operations budget. Each involved a separate procedure. The systems which are analysed below applied in the period after the 1975 decision to loosen restrictions on the firm.

The most important body controlling industry was the General Organisation for Industry (GOFI). This was part of the Ministry of Industry. GOFI's board was chaired by the Minister for Industry and its Deputy Chairman acted as day to day head. On the board were Secretaries of State at the Ministry of Industry responsible for different sectors, under-secretaries from the Ministry of Planning, Finance, Economics and Industry plus the head of the Central Agency for Public Mobilisation and Statistics. In theory therefore, other Ministries were involved in decision making with GOFI, a body belonging to the Ministry of Industry.

Planning a new project involved a complex procedure which is described below:-

### Planning a Public Sector Project of Under £E500,000

1. Project Department of firm submits project to the:
2. Company Board of Directors which submits the project to:
3. GOFI Technical Department which reviews projects along with those proposed by GOFI.
4. GOFI Study Committee (representatives of GOFI technical, legal and financial departments) plus company projects department examine projects. (+ sector secretariat in Ministry of Industry).



5. Feasible projects identified and Ministry of Planning informed.
6. Submission of projects for inclusion in 5 year plan.
7. Ministries of Planning and Finance establish funds in consultation with other Ministries. (Since 1980 this task has been carried out by the National Investment Bank).
8. Finance Committed for projects in the 5 year plan.

This procedure involved consultation with GOFI, two of its departments, the Ministries of Finance and Planning and their representatives. The Ministry of Industry was involved throughout via its sectoral secretariats both formally and informally. Once this procedure had been complete and the new planning period had started the process of implementation could begin.

#### Implementation of a New Project

1. Approved projects referred to Committee for preparation of tenders.
2. Tenders called for and evaluated.
3. GOFI Technical Committee recommends tender.
4. GOFI Decision Committee (Deputy Chairman of GOFI, Sector Secretary, Company Chairmen, GOFI General Managers, Financial and Legal Department representatives, Ministry of Finance and National Legal Council representatives, plus GOFI experts) reviews technical committee findings and confirms them.
5. Decision Committee recommendation submitted to the Board of GOFI.
6. Approved tenders acted upon by GOFI or by the company.

This six stage procedure involved consultations with four GOFI bodies including representatives of other Ministries and government bodies. Numerous personnel were involved more than once in the planning/implementation procedure.

The annual capital budget provided funds to cover replacement investment (depreciation). The procedures for its approval were also complex and bureaucratic. Firstly the firm prepared its capital budget for the approval of its general assembly. Then the budget was presented to GOFI. The Higher Sector Council was also informed. GOFI and the Ministries of Planning plus Finance considered the budget along with that of other firms. The decision of these bodies gave rise to the National Annual Budget. The firm was then given a capital allocation and the Higher Sector Council was notified. At least six bodies were therefore involved.

The annual operations budget went through an equally complex procedure. The firm prepared an operations budget which was submitted to its General Assembly. It was then discussed by the Higher Sector Council. Finally it went to the Ministry of Industry where the Undersecretaries of Production and Finance discussed it with the Ministries of Planning and Finance. Approval then went back to the firm via the Higher Sector Council.

The Planning system in the 1970s was highly centralised. Decisions were made by ministers on all matters of substance. The firm had a role in supplying information and making requests. The decision then went down to it after bargaining between the tiers of the administrative hierarchy and between the different sectors of the economy and interest groups.

The complexity of the procedures is an indication of how limited the degree of managerial initiative was in the late 1970s. These controls applied to investments of over £E500,000. Smaller projects could be carried out solely at the firm's initiative if it had surplus funds. Such resources were not easy to accumulate in view of the tight budgetary control which firms were subjected to. Only 10% of profits could be retained as reserves for disposal by the company. Depreciation was on a historical rather than replacement cost basis, which squeezed companies during the period because inflation had accelerated. There were some additional funds not subject to external control but these were not usually very significant. Finally the debt position of many firms was worsened by the fact that the state banks applied market criteria to them when lending without making allowance for the social role of the public sector in supplying commodities at below market prices. By relying on short term credit, firms increased their debt to such an extent that only the Treasury, by direct action, could prevent them becoming insolvent (1).

Consistent and feasible targets were hard to draw up because of instability in the Ministerial tier of government and because of the bureaucratic nature of the administration. These factors were in addition to the impact of the price system. The overall plan framework was less important politically than the sectoral priorities which it indicated; reflecting the influences of more powerful Ministers or the President. This was because short term objectives dominated over longer term ones. Targets were drawn up at a macro-economic level

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(1) B. Hansen and S. Radwan 'Employment Opportunities and Equity in Egypt' P213-4.

(i.e. in the government), but at the level of the firm plans often had to be subordinated to instructions from above about the need to hold down prices. The targets were seldom totally unrealistic: in the 1970s attempts were made to make them realistic. They were therefore not designed to force major changes in attitudes, behaviour and institutions. Nor did mechanisms exist to permit this. Managers and other key personnel were not directly rewarded for meeting or exceeding plan targets. Bonuses were awarded after the event to whole categories of employees on the basis of profits attained or according to their status in the firm. Wages were increased by government but were not related to productivity changes.

It is significant that throughout the 1970s, despite the move towards a less interventionist economic policy, plans were continuously announced. It was felt that in this way the Government would maintain its developmental role in the economy even if its influence was to be reduced.

### The Plans

The first and only comprehensive plan to be implemented was the 1960/1 to 1964/5 Five Year Plan issued in 1960. It was abandoned before its completion and the second five year plan (1965/6 - 1969/70) was prepared but never implemented. After that planning became a short term matter; the preparation of a ten year plan, in two five year sections from 1973 was a formality. The first half of the plan 1973/82 was discussed by the Cabinet and by Parliament in 1972 and 1973 but not adopted. The failure to adopt the plans testified to the government's inability to generate a consistent and feasible set of targets during a period in which foreign currency was scarce.

A fresh start was made in 1974 when an interim plan for the period July 1974 to December 1975 was adopted. This was formed by five year plans for 1976-80, 1978-82 and 1980-84. The 1978-82 plan was the first 'rolling' one, designed to take account of current achievements and changing priorities: each year the plan would be extended by a year so that greater continuity and reality in setting targets would be possible (1).

This was the formal structure in which the economy was supposed to operate. In fact the 1978-82 plan had not been submitted to Parliament by January 1978 and the Minister who drafted it was not in the Cabinet by the latter date (2). The interim plan for 1974-5, which was one of the most effective in terms of targets attained, typified the approach of the plans, even though its aims were more modest than the five year ones. It included among its priorities the reconstruction of the Suez Canal area, which has been a major success in recent years. Completion of projects already started, increasing capacity utilisation in industry and investment in 'strategic' projects to meet basic needs were also priorities. This plan was important because it was the first to be issued after the formal introduction of the Open Door Policy in 1974. It therefore projected a major increase in private investment, including foreign investment and stressed the importance of productive sectors rather than social services.

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(1) Arthur D. Little Inc. 'An Assessment of Egypt's Industrial Sector'

(2) A.D. Little Inc. 'An Assessment of Egypt's Industrial Sector', 1978, Footnote, P.83.

The 1978-82 plan included the following priorities:-

1. Accelerating the economic growth rate.
2. Changing the pattern of investments to strengthen development efforts.
3. 'Correcting' the balance of payments.
4. Providing rational decision making at national and enterprise levels.

These were vague and interconnected objectives, but few of the variables were under the control of the planners. They could only issue pious words and specify vague means for reaching their objectives. The two main ones in the 1978-82 plan included £E3 billion investment target and an increase in industrial production of 63% between 1977 and 1982.

By 1979 the emphasis had changed with a growing realisation of the need for expenditures in order to maintain social stability. The 1980-84 plan issued in 1979 therefore stressed the need, inter alia, to meet the housing requirements of a growing population. The planners explicitly recognised the problem of having a high income class consuming conspicuously amidst a large lower middle class with low or even falling real incomes (1).

The plan called for a review of subsidies to ensure that those in need received the benefits, a review of pricing policy and improved coordination of investments. Within a year pricing policy became even more centralised. The Minister of Planning who was calling for the

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(1) Ministry of Planning 'Egypt's Development Strategy, Economic Management and Growth Objectives 1980-84' Introduction.

review of pricing policy - towards a more liberal system - was charged, as Deputy Prime Minister for Economic and Financial Affairs in 1980, with implementing tighter controls. This was an indication of the powerlessness and lack of influence of even the most senior of planners.

The 1980-84 plan also called for projects with a concentration on Egypt's resource base and a 64% increase in GNP over the five years of the plan. It aimed to achieve a gross fixed investment rate equal to 24.5% of GNP of which only 4.5% would be financed from abroad. This compares with 13.7% of investment actually covered by external resources in 1978 (1).

The 1980-84 plan also recognised the inter-relationship between a number of policy variables. It called for a reform of subsidies so as to increase efficiency. This would mitigate the immediate effect on prices of the removal of subsidies (2). Increased domestic savings were called for and could be achieved by higher public sector's profits plus a 'rationalisation' (presumably this meant a reduction) of government current expenditure (3). The plan was prepared in 1979, one year before subsidies were increased and the public sector's limited autonomy further restricted.

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(1) Speech by the Minister of Planning in 1979 draft entitled 'Egypt's Development Strategy, Economic Management and Growth Objectives' P26-39.

(2) A.R.A. Meguid, Minister of Planning Egypt's Development Strategy, Economic Management and Growth Objectives 1980-84' P21

(3) A.R.A. Meguid, op cit, P24.

## Results:

### The Pattern of investment

The pattern of investment shows little change in the 1970s compared to the 1960s. Agriculture's share fell to even lower levels in the early 1970s than in the 1960s and picked up towards the end of the decade as problems associated with the supply of food increased. (see Tables 2-4).

The share of industry, mining and petroleum exceeded its share in GDP by around 8-10%.

Table 2: Selected shares in total investment during Five Year Plans issued in the 1970s (% of total investment)

	1976-80	1978-82	1980-84
1. Agriculture, Irrigation and Drainage	9.3	8.6	12.0
2. Other items relating to Food Security (1)			6.0
3. Industry and Mining	26.3	23.7	12.5 (2)
4. Petroleum	6.3	5.5	3.0
5. Housing & Public Utilities	20.7	11.8	16.3
6. Social Services	10.0	9.7	8.0
7. 1.-6. as % total investment.	72.6	59.3	57.8

Sources: 1976-80 Atkins Planning Ltd 'A Strategy Study of the Egyptian Metallurgical Industry' 1977 Appendix 1.

1978-82 Central Bank of Egypt Economic Review Vol. XVIII, No. 3 & 4, 1977, P144-6

1980-84 A.R.A. Meguid, 'Egypt's Development and Strategy Economic Management and Objectives 1980-84' P34-36.

- Notes:
1. Includes investment in the fertiliser sector. Food security was defined as a sector in 1980.
  2. Total industrial investment equalled 20% of total investment. Reclassification of investment discussed in text.



Table 3: Gross Fixed Investment by Sector (%), Years 1960/1 to 1979.

	1960/1	1970/1	1971/2	1974	1977	1978	1979
Agriculture	7.4	6.1	7.5	5.1)	7.7	8.2	8.1
Irrigation & Drainage	9.6	5.9	5.8	3.4)			
Industry, Petroleum	30.1	38.4	31.6	36.6	41.1	34.8	37.0 c
Electricity	2.5	5.8	6.9	4.7	5.7	6.8	6.6
Construction	N.A	1.5	1.0	1.7	2.5	1.7	2.2
Transport	33.1	21.8	26.5	29.9	24.5	17.5	25.5 d
Trade & Finance	N.A	3.0	0.8	0.8	1.7	1.9	1.1
Housing	8.5	8.1	10.6	8.0	9.8	6.7	4.5
Public Utilities	3.4	4.7	3.4	4.5	3.5	3.9	9.9
Other Services	8.7	5.9	6.9	6.8	5.4	8.3	9.6
Less Expenditure on Land Purchases	-3.3	-1.2	-1.1	-0.8	-1.9	-1.9	0.5

Source: 1960/1-1978: K. Ikram 'Egypt: Economic Management in a period of Transition' P404-405, 1979.

1979: 'Recent Development in The Egyptian Economy',  
Ministry of Economy, Cairo, January 1981. Economic  
Studies Unit

N.B. Figures do not add up to 100% in original.

a) Includes mining.

b) Includes communication

c) Includes exploration outlays by foreign and domestic oil  
companies.

d) Includes storage and Suez Canal.

Plans issued during the 1970s were responses to the economic  
situation. They presented an opportunity to change course if necessary  
or to reinforce existing patterns.

Between 1967 and 1975 industry's share of total investment  
increased. This was a result of the fall in percentage of total  
investment going to Electricity and Agriculture after the completion

of the Aswan High Dam and of increased expenditure on petroleum exploration. The latter, together with inflation, pushed up to current value of industrial, petroleum and mining investment between 1970/71 and 1978 by 500% (1).

Table 4: Gross Fixed Investment in 1975 prices, 1974-79 (£EM)

	1974	1975	1976	1977	1978	1979
Commodity Sector	395	588	690	707	846	914
Agriculture	60	95	85	114	113	137
Industry & Mining	212	287	326	364	434	408
Petroleum (1)	78	122	157	131	114	220
Electricity	33	33	52	68	112	112
Construction	12	31	70	30	73	37
Distribution Sector	213	399	332	297	406	460
Transport & Communication(2)	206	383	315	282	389	432
Trade & Finance	7	16	17	15	17	18
Service Sector	142	296	232	235	281	323
Housing	57	177	108	93	91	77
Public Utilities	34	46	39	45	58	83
Other Services	51	73	85	97	132	163
Total, all sectors	750	1283	1254	1239	1533	1697

Source: Ministry of Economy, Economic Studies Unit 'Recent Developments in the Egyptian Economy' January 1981 P17.

1. Includes exploration outlays by foreign and domestic oil companies.
2. Includes storage and Suez Canal investments.

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(1) K. Ikram op cit P261 & P404-5

A comparison of the plans drawn up in 1975, 1977 and 1979 reveals two kinds of changes (Table 2 above). The first was a presentational one: investment categories were regrouped under a new heading: Food Security. Included in this group were items previously under the industry title. The reclassification reflected the authorities' desire to be seen to be addressing current problems more directly. The second type of change was more than presentational: investment priorities were altered. The share of agriculture, irrigation and drainage after falling in the first two plans was increased, but only to 12% of the total. The 1980-84 plan significantly suggested that investment would form a slightly lower share of GNP than in 1975, another reflection of the urgent need to meet basic consumption needs.

Table 4 gives data on investment in real terms. During the period 1974 to 1979 total fixed investment rose by 129%. If that in the petroleum sector is excluded then the growth was nearly as impressive at 120%. A significant part of this was due to stock accumulation in 1975.

### The Rationality of the Targets

According to the Ministry of Economy the incremental capital output ratio (ICOR) for agriculture measured over the period 1974 to 1978 was 3.96; high by internal standards (1). Total investment in agriculture in that period was £E467m. The increase in output was £E118m. The Ministry of Economy excluded depreciation from their calculation of the ICOR (£E467m - £E118m).

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(1) Ministry of Economy, Economic Studies Unit 'Recent Developments in the Egyptian Economy' January 1981.

Within agriculture, the investment trend, at least until 1975, was to concentrate funds on new lands rather than existing ones (the so called 'New Valley' and other areas versus the traditional Nile Valley).

Table 5: The Allocation of Public Sector Investment in Agriculture 1960-75 (%) £Em\*

	'Horizontal Investment' (New Lands)		'Vertical Investment' (Old Lands)	
1960-65	82.0%	£154.5	18.0%	£33.8
1966-70	84.5%	£176.2	15.5%	£32.4
1970-75	68.5%	£127.1	31.5%	£58.7
		£458.8		£124.9

Source: I.H. El Issawy 'Interconnections between income distribution and economic growth in the context of Egypt's Economic Development' Draft, December, 1979.

\* Private Sector Investment 1960-75 amounted to only £E39.5m.

A comparison of Tables 2 and 3 above shows that investment in agriculture in 1977 was even larger than the plan target set by the 1976-80 plan. This was also true in 1978 compared with the 1978-82 targets.

Investment in the old lands increased as a share of total agricultural investment from 15.5% to 31.5% in 1970-75. This meant that it only received 4.2% of total investment in all sectors in 1971/2 and 2.7% in 1974. The ICOR for investment in the old lands was

13, excluding depreciation, assuming, very optimistically, that 20% of output in the period 1970-75 came from the new lands. This suggests a fundamental and large scale misallocation of resources, even if the ICOR calculation is very rough. In fact, according to the National Bank of Egypt, land reclamation (horizontal expansion) failed to add any land to the agricultural area between 1972 and 1978 (1).

The ICOR for industry was even higher 5.56. If 10% is deducted for depreciation then it was 5.00. For the economy as a whole it was 3.24, a result of relatively high productivity in distribution and part of the service sector.

Short term ICORs show why high investment was needed. After an improvement in 1977-78 there was a further deterioration as the step-like increase in industrial production, which resulted from the increase availability of foreign exchange to buy raw materials and spare parts, ended.

Table 6: Short Term Incremental Capital Output Ratios, 1975-1980

Increase in real GDP Measured over	Increase in real Investment Measured over	ICOR
1975-76	1974-75	5.35
1976-77	1975-76	6.10
1977-78	1976-77	4.35
1978-79	1977-78	5.10
1979-80	1978-79	5.59

Sources: GDP: 1975-79 International Financial Statistics 1981 Hand-Book IMF.

1980: Estimated 8.5% increase, US Embassy, Cairo  
January 1981

Investment: Table 4 above.

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(1) National Bank of Egypt Economic Bulletin Vol.xxxi No.4 1978 P349.

Industry required large scale investment in part because of the tendency to concentrate on new projects often on a large scale and in heavy industry. The failure to allocate funds to existing projects, on a sufficient scale, meant that output growth was limited, at least in the short term, because of the gestation period of new investments. According to Ikram, 40% of investment in the manufacturing sector between 1968 and 1979/80 (when his study was published) went on the Helwan Steel Complex (1).

This had an administrative impact. Plans to expand the Iron and Steel Works at Helwan were considered too big for Hadisolv - (the Iron and Steel company) itself. They were also thought to be too detailed for GOFI to cope with and so a new body, the General Organisation for the Helwan Iron and Steel Complex, was set up. It survived the expansion programme and became a fixture in the bureaucracy, thus providing jobs and another vested interest fighting for resources.

A cumulative process operated here. Large and inefficient plants required a lot of investment to maintain them. Investment funds had to include foreign currency (which was scarce in the first half of the decade) so that spare parts could be purchased. Given the symbolic importance of plants such as the Helwan Iron and Steel Complex, resources were made available on a scale which market forces would not have indicated. Investment was seen in political terms; as something to support 'important projects'. It was allocated according to political criteria. If the Helwan Complex did not get a large percentage of the investment funds available then it might not be able to function. This would have led to unemployment, something which the government feared. Once a precedent had been set then budgets tended

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(1) K.K. Ikram op cit P252 Footnote 2.

to increase year by year. A cut in the budget of such a prestigious project would have been politically suspect and so the easiest course was to expand the investment budget whenever possible. This reinforced the status quo and added to financial pressures in future years.

Firms like the Helwan Complex were not always profitable and so could not always pay for the funds which they received. They were not charged a market interest rate nor could they themselves charge market prices for their products. A web of subsidies therefore evolved which made accounting almost impossible. They were an integral part of the way in which the public sector ran and some of their consequences are examined in the following chapters.

#### Targets Versus Achievements under the Plans

The targets for GDP growth became more ambitious as planners realised the extent of gains from oil and other 'semi-exogenous' factors. The economy's performance in most years was worse than the more optimistic plan targets. 1975 and 1978 were exceptional years in terms of actual growth but reflected weak growth in the years 1974 and 1977. (See Table 8).

Given the extent of 'semi-exogenous' factors it is important to see how far the planners anticipated the sources of growth in terms of leading sectors. Unfortunately, data on sectoral growth rates in real terms is not available for the whole decade and so only a partial evaluation is possible. By concentrating on the later years of the decade it is possible to evaluate the plans after the planners had had some experience of the more liberalised economy.

Table 7 below provides data for this kind of analysis.

Table 7: Sources of Growth in GDP: Targets and Achievements

<u>Sector</u>	<u>1978-79 (%)</u>	
	<u>Planned</u>	<u>Actual</u>
Agriculture	3.5	0.3
Industry &	9.7	10.5
Mining	22.5	10.3
Petroleum	22.5	10.3
Electricity	13.3	3.9
Construction	9.8	3.2
Consumption	<u>8.3</u>	<u>7.3</u>
Savings	26.6	-12.0
Gross investment	4.4	2.0

Sources: Planned growth: 1978-82 plan

Actual growth: Ministry of Economy op cit P10.



Table 8: Plans in the 1970s: Targets & Achievements - % Real Rate of Growth of GDP p.a.

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
<u>Planned Growth of GDP</u>											
1973-1982 Plan				6.5	6.5	6.5	6.5	6.5	7.2	7.2	7.2
1974 Plan					5.9	6.0					
1974-1975 Plan						9.5					
1976-1980 Plan							9.5	9.5	9.5	9.5	9.5
1978-1982 Plan									12.3	12.4	
1980-1989 Plan									11.6	11.6	11.6
<u>Actual Growth of GDP</u>	5.0	4.0	2.5	4.1	5.1	13.7	7.8	7.9	10.1	8.7	8.5

Sources: Planned Growth

1973-82: 'Le Budget et le Plan Decentral 1973/82 en Egypte', Office Arabe de Presse et de Documentation, Damascus (1973/4).

1974: Central Bank of Egypt 'Economic Review' Vol.xv No.1, 1975.

1974-75: National Bank of Egypt 'Economic Bulletin' Vol.xxvii No. 4, 1975.

1976-80: Atkins Planning Ltd 'A Strategy Study of the Egyptian Metallurgical Industry 1977 Appendix 1.

1978-82: Central Bank of Egypt 'Economic Review' Vol. xviii, No. 3 & 4, 1977

1980-84: A.R.A. Meguid 'Egypt's Development Strategy, Economic Management & Growth' 1979.

Actual Growth: Calculated from 'International Financial Statistics', IMF, Various editions.

Agricultural targets were modest but even they were not met. Industry did slightly better than planned but the petroleum sector did much worse. The latter was particularly hard to forecast due to the influence of international prices on volumes produced in Egypt. All the other sectors listed did worse than planned.

The share of investment in the agricultural lands of the Old Valley increased during the 1970s although the volume of investment grew only slowly. It is significant that the bias towards the New Lands continued despite the experience of the 1960s, when such investment yielded little.

Consumption (of the public and private sectors) grew more slowly than planned but savings were 38% lower than the planners had calculated. Partly as a result of this, investment growth was half the level planned.

All of these figures are approximate, given the weakness of the data and the fact that the deflation of current price data on consumption, savings and investment was done with GDP data index, the only one available. The results do indicate the general problems with the plans in the late 1970s: They over-estimated savings especially from domestic sources. The reasons why savings were lower than planned to such a large extent will be analysed in Chapter 6.

### Conclusions

A number of conclusions can be drawn about the planning system. Firstly, it suffered from institutional weaknesses. These included the fact that decisions were made outside formal procedures.

Bargaining between ministries, as to which projects would be selected, was often highly political. There was a lack of interaction between the government departments at the technical level. The setting of priorities and coordination in the economy was affected by enterprises obtaining funds and commitments for external finance. Particularly important here was the desire and ability of public sector firms to channel resources into joint ventures with the private sector thus partially circumventing what investment planning there was. Different decisions were made on the basis of varying criteria but the lack of consistency was worsened by instability in the government. For example, between 1970 and 1980 there were seven Ministers and four Deputy Prime Ministers for economic and financial affairs (1). The instability amongst Ministers and their officials accompanied frequent changes in organisational structure and responsibility. There was also high turnover in senior management of the public sector.

Planning decisions were therefore made on the basis of uncontroversial requests from the firm or resulted from political pressures. This weakness in the planning system increased as the economy moved towards a more liberal ideology. The Ministry of Planning's power and influence, weakened by the problems faced in the 1960s, decreased even further.

The policy making process was dominated by short term, ad hoc decision making, within the framework of annual budgets. Insufficient attention was given to optimal investment criteria, something which had happened in the 1960s. Inflation in the late 1970s pushed the

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(1) See Chapter 2

government into adopting tough price controls and this increased the amount of ministerial interference in the running of public sector firms. Inflation was in part a consequence of the liberalisation programme, as shown in subsequent chapters. By doing so much to open up the economy, the government helped to increase domestic demand without boosting domestic supply. Liberalisation of the foreign sector resulted in an increase in controls on the domestic economy. Holding down public sector prices had major budgetary and financial consequences which will be analysed in Chapter 7.

Subsidies, needed to hold down prices, did not discourage the government from investing in public sector. Investment was seen as a straight forward way of increasing output despite the low capital output ratios which prevailed in many of the sectors receiving high investment.

These policy making weaknesses were compounded by the enormous pressure of day to day business on key decision makers. That pressure was partly responsible for their failure to analyse the long term consequences of ad hoc decisions.

The third area of criticism was that the plans were not comprehensive. They were in fact little more than a list of investment projects and exhortations usually aimed at the government itself.

Within the firm there was often a separation between the development plus planning functions and those of implementation and operations. As a result investment was frequently directed to areas of low demand. The firm also suffered from the bureaucratic problems which plagued the government.

The absence of direct rewards for plan fulfilment at any level meant that few had incentives to use their own initiative. This was important at the level of management in the firm. Wage and salary rates were fixed by the government with Presidential interventions. Bonuses were related to grade or rank rather than achievement. At the level of the firm, profit sharing prevailed but profits were a residual squeezed between mounting costs and often fixed prices. Industrial managers often succeeded despite the planning system and in the absence of an informal system which could help them deal with shortages, delays and other obstructions which prevailed. This applied to government officials at all levels.

Serious misallocation of investment plus failures to plan and provide finance were serious problems. The plans did not balance inputs and outputs nor did they provide a mechanism for doing so.

## Chapter 5: Pricing Policy

### 1. Its relationship with Planning & Investment Policies.

Although the planning system was weak this did not mean that the government was uninvolved in the economy. Through its pricing policies it exercised detailed control over industry in the public sector and indirect control over agriculture. Pricing policy had direct effects on output, but it also had indirect effects through investment and planning.

The plans drawn up in the 1970s were on the basis of prices which existed in the economy. These were based on a mixture of market and administered forces with an increasingly important role being played by the foreign sector, mainly through the effects of import prices. Hence the investments suggested in the plans were in part responses to demand-supply relationships observed in the economy. The planners used sophisticated techniques to estimate what ought to be produced under hypothetical conditions in which scarcity prices existed. The plans were in fact drawn up as a result of the complex procedures, outlined in the previous chapter, under which planners lacked the power to enforce efficiency criteria on the decision makers. In order to understand the outcome and nature of the investment programme it is therefore necessary to analyse pricing policies.

During the 1970s inflation accelerated; although this was not fully shown up in the official price indices, which were dominated by subsidised commodities. As inflation threatened the real incomes of the politically important urban population, the government increased

wages faster than prices and the minimal productivity gains in industry. Inflation was also a consequence of the liberalisation of the economy. This ironically, resulted in a loss of managerial freedom in industry; a move away from liberalisation. The consequences of this were more significant than any planning decisions taken in the latter half of the decade.

In order to understand the context in which many public sector companies worked, the following section analyses the general structure of markets and the details of those for two industrial goods and their evolution over the decade.

#### Pricing Policy: The Structure of Markets

By 1975 50% of all industrial output was subject to direct price control by central government. At the end of 1978 this had been reduced to 35%. In 1980 control was reasserted and most firms in the public sector lost the freedom to determine prices. Public sector prices rose by 1.6% p.a. on average between 1973 and 1975 compared with 19.7% in the private sector. Between 1976 and 1977 the figures were 3% and 10.1% respectively. Public sector prices were frozen, or even cut, in 1980 against a background of accelerating inflation and so the differentials widened in that year. To some extent the underlying inflation rate varied between sectors, but the main cause of the differential was government policy (1). This policy affected the profitability of the public sector and as a result much debate occurred on the need for reform.

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(1) S. Ranney 'The Open Door and Industrialisation in Egypt: A Preliminary Investigation', Centre for Economic Development University of Michigan, Discussion Paper, August 1980 P32 T.XIV.

The debate failed to highlight the effects of government policy on the public sector. By frequently holding prices below their market levels, the government caused dual markets to develop; one at the official level price and the other at free (or 'black') market prices. This had a number of consequences for the economy. Firstly, the producer's incentive was limited because it could not legally obtain what the market would set as the price and hence its profit. This applied mainly to the public sector, which was subject to price controls most severely and effectively. To meet demand, production elsewhere was in effect encouraged, often on an informal or even illegal basis. The latter, as well as the former, was often sold privately. Profits resulting from private production were higher than those which would have resulted from a competitive market. There were efficiency as well as distributional consequences throughout the economy, leading to shifts in profit away from the public sector.

Table 1 illustrates the dual market system and the magnitudes involved for two commodities. The official price included the cost of production (with some input prices themselves being subsidised), excise duties and a 'price difference'. The latter was equivalent to an indirect tax. The cost of production was measured by the actual



Table 1: Official and Market Prices for Cement and Reinforcing Bars  
1972 - 1978.

	Cement (£E/Ton)		Reinforcing Bars (£E/Ton)	
	Official Price	Market Price	Official Price	Market Price
1972	N.A.	N.A	100	160-180
1973	11	18-25	100	170-200
1974	12	25-40	120	170-200
1975	14	40-55	125	180-210
1976	14	45-60	150	180-190
1977	18	32-55	150	200-220
1978	18	75-90	170	230-270

Source: N. Choucri et al 'Migration and Employment in the Construction Sectors: Critical Factors in Egyptian Development' Cairo - M.I.T. Programme, October 1978 P103 & 105.

outlay for an input rather than by calculating the marginal opportunities involved. A margin was allowed over costs which was equal to a fixed profit rate, usually of 10-15%. Profits under such a system were neither an indication of efficiency nor a guide to optimisation. Hence the calculation of one price took into account other prices paid, the latter possibly subsidised. These were therefore cumulative effects as each price calculation had built into it the non-economic considerations which determined the prices of inputs used.

Table 1 also shows that the 1973 market price for cement (defined as the middle of the range £E18-25 per ton) was 95.5% above the official price. By 1978 the difference was 358%. In the case of reinforcing bars the divergence was 85% in 1973 and 47% in 1978. The official

price of cement rose by 63.6% between 1973 and 1978 compared to an increase in the market price (again measured by the mid-point of the range) of 284%. For reinforcing bars the comparable figures were 70% and 35%. Official prices were allowed to rise by similar proportions for both commodities although the market price for cement rose far more than that for reinforcing bars.

Free market prices were not only a reaction to what could be obtained when public sector producers charged less than the market clearing price. They were also related to the quantities available on the market as a whole and this changed over time. Imports in the first half of the decade were tightly constrained by foreign exchange shortages but as that constraint eased in both cases, they increased as a share of total supply (1). Low official prices may have also had the effect of encouraging smuggling out of the country and other misappropriations of outputs at official prices.

There was, in addition, a lack of coordination by the authorities about pricing. Industrial prices were controlled by the Ministry of Industry but different boards, at varying levels of authority in the bureaucracy, controlled or influenced difference prices. Luxury goods attracted markups and cost increases were passed on to the consumer more readily than those related to essential items.

The latter were mainly the responsibility of the Ministry of Supply. It bought imported and locally produced basic commodities. Fixed quantities were sold at rationed prices to ration card holders (all individuals were entitled to ration cards regardless of their

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(1) N. Choucri, R. Eckhaus and A. Mohie Eldin 'Migration and Employment in the Construction Sector: Critical Factors in Egyptian Development' PI02, June, 1974.

income). Additionally, varying quantities of these commodities were also supplied on the so-called free market. These were available on a first come first served basis at fixed prices which were well above the rationed ones. These prices were also subsidised although in some years, for some commodities, the subsidy was negative (i.e. a tax).

A similar pattern applied to a range of commodities. There were some price rises in 1978 and 1979 as the government tried to liberalise the domestic economy and reduce the budget deficit but in 1980 President Sadat intervened to reduce living costs and reversed the trend (see Appendix 2).

Private gains from reselling rationed or price controlled commodities was not confined to important industrial items like Cement. Rental incomes, as defined by Krueger (1), were obtained in many ways. Meat bought at £E0.70 a kilo from government shops was sold to private butchers for £E2.00 a kilo. Apartments were sublet at huge profits throughout Cairo (2). These and many other abuses discredited a system of subsidies designed for welfare purposes. The abusers made abolition or modification of the system extremely difficult. If the price of all meat, for example, was determined by the market then those who resold it could not make profits in the manner described above. This would have hit the urban working class who, although poor, were by no means the poorest in Egypt but were politically important.

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(1) A.O. Krueger 'The Political Economy of the Rent Seeking Society American Economic Review, June, 1974.

(2) 'The Economist' 10 January, 1979.

These kinds of activities created an atmosphere of cynicism which had economic and political consequences. The allocation of basic commodities could not be determined entirely by market forces because many Egyptians were too poor to pay the international prices which would have resulted for some commodities. On the other hand, the socialist inheritance of subsidies was discredited by corruption. An ideological void was created in which people fought for their own immediate best interest without the invisible hand maximising that of the nation as a whole.

### Cotton

One of the most important sets of prices in the economy was that of cotton. Trade in cotton was controlled by the state and until 1977 it was Egypt's largest earner of foreign currency.

The export price for cotton was determined on international markets and it increased by 125% between 1970 and 1974 (Table 2). That paid by domestic spinning mills to the government was held constant during the period. The price paid to the farmer rose by 29%. Demand increased from the mills as a result of the low price and this restricted the amount of raw cotton available for direct export. Production costs rose by 87% between 1972/3 and 1978 (Table 4) while prices rose by 76%. Yields increased so that revenue per feddan planted increased. This was particularly true in 1978, an exceptionally good year from a climatic point of view. Profitability was squeezed in the years 1972/3 to 1978 by the government, which controlled the prices on inputs and outputs. Domestic users of cotton were heavily subsidised in comparison to international price levels.

The government made a loss on the internal side of the trade by selling for less than it paid, but made gains on the international side where higher, international prices prevailed.

Agricultural imports such as pesticides and seeds were subsidised, drainage and irrigation were provided without charge by the state but farmers were obliged, by law, to plant quotas of cotton. As the price which they received was fixed by the government at much less than the export price, many found it worthwhile to produce crops which were not subject to controls. Although fines were imposed on farmers not meeting their quotas, it was often more economic to pay the fine. The next effect was to lower the acreage available for cotton production with consequent export revenue losses (1). In 1970-74 cotton took an average of 1,551,000 feddans. In 1975-78 it took 1,302,000, a fall of 16% (2).

The fall in exports was considerable: from 6.01 million metric kantars in 1972-3 to 2.49 millions in 1977-8. In 1979-80 the figure was about 2.7 million as a result of a good harvest and a 27% increase in the farm gate price (3).

A major factor behind the slow growth of cotton output was the low price paid to the farmer both in relation to the costs of production, the cost of living (to the extent that he was not self sufficient and therefore relied on purchases for his livelihood) and the price which could be obtained for other products.

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(1) The Financial Times (F.T) Supplement on Egypt 30 July 1979.

(2) K. Ikram 'Egypt: Economic Management in a period of Transition' John Hopkins University Press, Baltimore, U.S.A. 1980, P414.

(3) F.T. op cit.

The increase in the farm gate price for cotton in 1979 was significant because it was the largest one granted. In 1974 and 1976 rises of over 20% had been granted but those in the rest of the decade were below 10%.

The price rise increased incentives to produce cotton at the expense of other crops or crop combinations. An examination of the net gains from the increased cotton price from 1979 provides an indication of the implicit losses which occurred before that year, as a result of the previously prevailing price.

The increase in cotton production carried out by farmers in response to the price rise will have affected the economy. The nature of this effect depended on long and short run area and yield elasticities for cotton; in other words, the degree of their responsiveness to price rises. The change in the cotton price cannot be considered alone; it needs to be placed alongside changes (if any) in the prices of alternative crops.

Table 2: Cotton Prices 1970 - 1979

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
								(a)	(b)	(c)
1. Farm Gate (£/ton)	115.38	115.64	125.97	123.87	149.21	161.91	203.17	219.35	221.1	281.5
2. Farm Gate (£E/feddan)	99.6	107.6	115.3	105.9	133.5	126.9	178.6	169.4	224.9	
3. Price to domestic spinners (£E/Kantar) medium staple	80.5	80.5	80.5	80.5	80.5	80.5	80.5			
4. Export Price (£E/Kantar at end of market year)	91.0	105.0	171.0	280.0						

Source: K. Ikram 'Economic Management in a period of Transition' op cit

- 1) P426-7 (Price paid by the government)
- 2) P424-5 (Price received)
- 3 and 4) P265 (Source does not specify Kantars. This was done by the author in a letter).
- a. updated April and October, 1978.
- b. updated April 1979
- c. Financial Times 30.7.1979 Supplement, price based on 30% increase in January 1979 over 1978 average.
- d. 1970 = 1970/1 etc

The Ministry of Economy has calculated the probable long and short run effects of the cotton price assuming no other changes in economic variables (1). Their main conclusions were that in 1979 (the short term effect) the area under cotton would increase by 7.4% and production would increase by 15.9%. The net revenue resulting from this would contribute £E72.4 m to National income and £E64.1 to exports (2). In relation to total national increase and exports in 1979 these figures are not large but in so far as they are net gains, they indicate the potential which existed in agriculture. Increasing the price of cotton had budgetary effect; the government would have to pay farmers more. It would recoup the extra cost by charging more for imports and this would not necessarily reduce the relative incentive to product cotton if all subsidised agricultural import prices were increased. In 1978 the government earned £E122.8 m from cotton (by selling it abroad at higher prices than it paid at home). The increase in the price paid to farmers would have cost £E70.8m. This would therefore represent a transfer within the economy from the state to agriculture (3). An alternative way in which the government could have the increased cost of cotton it bought, would have been to increase the price it charged to the mills.

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- (1) Ministry of Economy, Economic Studies Unit (E.S.U) 'Policy Study on Pricing and Taxation of Major Alternative Agricultural Crops', Cairo, August 1979.
- (2) Calculated from figures in Appendix 2 of E.S.U. op cit.
- (3) E.S.U. op cit P27-29.



The idea that the cotton price should be increased is based on the belief that insufficient incentives existed before 1979. Cotton was a state monopoly and its production was forced (by law) on many producers who could get a higher net revenue from producing other crops. From the point of view of agricultural strategy, it has to be asked whether quotas for cotton production should have existed here at all. Taking summer and winter crops together, the average net revenue in 1978 of producing cotton and berseem in rotation at the 1978 price, was £E112.101 per feddan. At the 1979 price this was estimated at £E166.671. These figures compare with £E260.553 for berseem and rice, £E255.363 for berseem and maize. The increase in the cotton price in 1979 therefore only made cotton a less unattractive a crop, reducing the disincentives to produce it (1).

By holding the price it charged the mills for raw cotton below the international price, the government was effectively protecting domestic producers from foreign competition. By valuing inputs and outputs at international prices it is possible to calculate whether this was efficient, in the sense of maximising output and exports.

In order to calculate the net contribution of a product to exports, two concepts are useful. The first is the amount of foreign exchange earned per £E1 of domestic resources used (FXR). This is calculated as a ratio of net potential foreign exchange earnings at international prices to domestic resource costs valued at their opportunity cost.

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(1) E.S.U. op cit table.

$$FXR = \frac{\text{Value of Exportable output} - \text{Value of traded inputs}}{\text{Value of factors of production} + \text{Value of non-tradeable inputs.}}$$

Domestic resource costs include depreciation, fuel costs, wages, the rental of land, interest paid inside Egypt and an imputed return on capital. These are calculated at domestic prices.

The second concept related to exports shows the amount of foreign exchange earned from £E1 of an exported product (FX0). This is the ratio of the difference between the value of exported output and the value of traded inputs to the value of exported output, all inputs and outputs being valued at international prices. Outputs are valued at F.O.B. prices, inputs imported or replacing imports domestically are valued at the C.I.F. import price of the import or its substitute. Those inputs which have been exported have been valued at the F.O.B. export price:

$$FX0 = \frac{\text{Value of Exportable output} - \text{Value of tradeable inputs}}{\text{Value of exportable output.}}$$

Related concepts can be used to evaluate gains to the economy. The first measures the amount of national income, at international prices earned in producing £E1 worth of an export product (VA0). This can be done by looking at the ratio of value added earned by the export and the value of exportable output. Value added is equal to the values of output of the exported product minus the value of all inputs, traded and non-traded. This can be summarised as follows:

$$VA0 = \frac{\text{Value of Exportable output} - \text{Value of tradeable and non-tradeable outputs}}{\text{Value of exportable output}}$$

Finally the value added at international prices earned by £E1 worth of domestic labour and capital (the latter in domestic prices) can be assessed (VAF). This can be expressed as follows:-

$$\text{VAF} = \frac{\text{Value of Exportable output} - \text{Value of tradeable and Non-tradeable inputs}}{\text{Domestic Factor Cost}}$$

These coefficients have been calculated for cotton yarn and fabrics produced at the Misr Spinning & Weaving Plant at Kafr-el-Dawar.

Table 3: Economic Returns from two Exported Cotton Products

	Yarn		Fabrics	
	1	2	3	4
Foreign exchange/£E1 domestic resources used (FXR)	-0.100	1.772	-1.071	1.395
Foreign exchange/£E1 of exported output (FXO)	-0.33	0.363	-0.339	0.442
National income/£E1 labour & capital used (VAF)	-0.544	2.084	-1.918	1.557
National Income/£E1 exported output (VAO)	-0.129	0.304	-0.431	0.350

Source: Data supplied by Ministries of Industry and Economy, Cairo  
Calculations from Ministry of Economy.

Notes: Outputs valued at FOB export prices, imports at CIF price  
Exchange rate \$ = £E0.70 used for all calculations.

1. Yarn calculations based on yarn mix actually produced in 1977
2. Yarn calculations based on assumption that fine yarns are produced only.
3. Fabric - Actual outputs and inputs 1977
4. Fabric - Assumes use of coarse yarn only

The data in Table 3 column 1 shows what actually happened in 1977. All the figures for yarn and fabric production show that the economy lost from the production of these products. The plant in question (Kafr-el-Dawar) may have been particularly inefficient but the negative returns indicate the extent to which that was permitted. The worst example is the loss of £E1.918 worth of national income for each £E1 worth of labour and capital used in fabric production at the plant. This compares with a potential gain of £E1.557.

The mills could make a nominal profit on their production because they bought their cotton (and other) inputs so cheaply; the price being fixed and subsidised by the government.

Column 2 & 4 show what would have happened to the four indicators if adjustment had been made to the pattern of inputs and outputs. Calls for such changes had been made at influential levels years before these results were produced, but to no avail (1).

The figures in Table 3 give an approximate summary of the losses to the economy from production in one plant and include the effects of government subsidy to the mills (charging them less than the farmer is paid). Raising prices charged to the mills would have reduced the subsidy bill and might have discouraged loss making production. Without other changes the plant might have had to close and unemployment would have resulted.

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(1) e.g. Dr. A.M. Kaissouni, in a lecture at the National Bank of Egypt, reprinted by the National Bank of Egypt, distributed with their Bulletin, March, 1974.

Table 4: Costs of Cotton Production (£E1 / Feddan) 1972-78

	<u>1972-3</u>	<u>1973-4</u>	<u>1974-5</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
Rent	25.27	26.10	26.11	32.00	31.92	
Wages	24.39	30.20	40.78	50.15	58.73	
Draftpower	2.64	3.35	3.37	5.90	5.22	
Machinery	4.96	5.53	6.52	7.72	10.08	
Seeds*	1.27	1.29	1.32	1.43	1.47	
Organic						
Fertiliser*	3.75	4.37	5.83	6.39	7.36	
Chemical						
Fertiliser*	8.37	8.10	3.46	9.22	9.12	
Pesticides*	4.70	6.07	9.40	7.31	7.38	
Other Costs	1.15	1.19	2.05	2.68	2.40	
Total Costs	76.50	86.20	98.84	122.80	133.68	143.04(1)

Sources: 1972/3 - 1974/5 K. Ikram 'Egypt: Economic Management in a Period of Transition' op cit P428.

1976-78 Ministry of Economy, Economic Studies Unit 'Policy Study on Pricing and Taxation of major Agricultural Crops'  
Cairo, August, 1979, Table 1a.

Notes: \*Subsidised Items

(1) Estimated, 7% increase over 1977, no detailed breakdown given in source.

In so far as cotton was a leading export sector so its output prices were determined by international market forces to a greater extent than other sectors which exported less. It therefore suffered less than other industries from price controls while at the same time benefiting from price controls on its inputs. It was also able to make use of subsidised credit. Interest rates were not determined by the market and the public sector had preferential access to credit available. The macro-economic and monetary implications of this are examined in Chapter 6. In so far as the cotton sector was profitable, at the prices which prevailed, it needed less of the subsidised credit than other sectors.

#### Pricing Policy and Public Sector Performance

The trend towards less control between 1975 and 1980 reflected deep dissatisfaction with the functioning of the public sector (1). It was pictured as highly inefficient, badly managed, wasteful and even corrupt. Extreme advocates of liberalisation wanted to sell parts of the public sector to private interest. The President's position was somewhere in the middle; he pushed for change and issued declarations about job security for public sector workers. By not specifying, in detail, his ideas for reform, he created a vacuum in which mistrust and uncertainty flourished.

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(1) According to the 1979 Plan, the public sector produced 57% of GDP.

The politics of this issue were significant because of the way in which the leadership, press and public perceived them. This influenced policy as much as the actual performance of the sector. In this connection, Boulding's view that perceptions are more relevant than any notion of the 'objective situation' in decision and policy making, is apposite (1).

Typical of the criticisms of the public sector was that made by the Parliamentary Budget and Plan Committee in 1973. It stated that the total fixed investment in the public sector in 1973 was £E4.245 billion. On this it made a profit of 2.4% or about £E102 million (2). Their criticism went much further than that of earlier Prime Ministers under Sadat who had called for reforms during Sadat's Presidency (3).

The complexity involved in evaluating the performance of the public sector derives from a pricing system which failed to reflect scarcities. It was used to deal with short run inflationary problems by such means as wage rises unlinked to productivity increases or subsidy rises to cover increased international prices of basic goods. When interest rates were increased in order to rationalise the use of capital and encourage savings some producers got special subsidies.

Pricing policy affected the valuation of output throughout the economy. The most dramatic example of this was with regard to energy prices.

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- (1) K. Boulding 'National Images and International Systems' The Journal of Conflict Resolution iii, 2 June, 1959, P120-1.
  - (2) J. Waterbury 'Egypt: Budens for the Past/Options for the Future' Indiana University Press, 1978, P291.
  - (3) Egyptian Gazette 30.12.1971 and BBC Summary of World Broadcasts 25.1.1972, ME/3897/A/5.

According to the Ministry of Economy's Economic Studies Unit, domestic sales of refined petroleum products created added value of £E270m in 1979. If those products had been sold domestically at world prices or exported, then value added would have been £E1.528 billion. The implicit subsidy was therefore nearly £E1.3 billion. Selling at the higher price would, amongst other things, have boosted GDP by a similar amount (1).

The rate of return calculated on the basis of existing prices is therefore often misleading. By using prices which reflected scarcities it is possible to calculate the social rate of return, indicating real gains or losses as a result of a firm's activities. Such calculations have been done and they show that in some areas the public sector's real performance was better than indicated by their financial rates of return. The latter is calculated using prices which actually prevailed in the economy. Of the twenty firms in Table 6, 16 had higher social than financial rates of return. The negative profitability of reinforced iron production reflects low selling prices on the official market as noted. The inappropriateness of the original investment in the iron and steel industry is suggested by the even bigger losses which would have occurred if international prices had prevailed.

Profits were not the only social or economic contribution made by public sector companies. These firms paid taxes and dividends to the government, made contributions to social funds for workers benefits and partly financed their own investments. As has been said, they also paid wages to many more workers than they actually needed.

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(1) Ministry of Economy 'Recent Developments in the Egyptian Economy' p.15



Table 5: Financial and Social Rates of Return of Public Sector Industries, 1977

	Financial Rate of Return - (F.R.R) as % of Capital (a)	Social Rate of Return - (S.R.R.) as % of Capital (b)
Reinforcing Iron	-18.9	-28.6
Tobacco	-1.3	80.0
Aluminium	1.8	2.8
Nitrogen Fertiliser	5.6	27.0
Food Flavouring	8.8	89.6
Food Canning	9.2	25.0
Knitwear (Cotton)	10.1	11.4
Vegetable Oil	10.2	272.5
Cement	11.0	40.5
Soft Drinks	21.6	57.8
Carpets	25.5	20.2
Starch	27.6	67.7
Underwear (Cotton)	28.1	32.7
Confectionery	29.2	39.2
Spinning (Cotton)	36.2	10.0
Biscuits	42.9	35.6

Source: H. Handusa 'The Impact of Economic Liberalisation on the Performance on Egypt's Public Sector' 2nd B.A.P.E.G. Conference, Public Enterprise in Mixed Less Developed Countries Sponsored by Boston University & Harvard Institute for International Development 2-5 April 1980 T.4.

a. FRR = Cash surplus - capital employed (fixed assets + inventories or stocks)

b. SRR = Social profit - capital employed where latter is fixed assets + inventories. Social profits = value of output minus value of traded and non-traded inputs minus value of domestic factors other than cost of capital employed. All quantities valued at shadow prices. Shadow exchange rate = £E0.70 when official rate was \$1 - £E0.65

The budgetary system also makes identification of public sector company profits a complex matter. The public sector was divided into two for administrative purposes. The first group consisted of public authorities mainly responsible for services. The second group was that of firms operating, until 1975, under public organisations. This group was the public industrial sector. Both groups remitted 65% of their profits, net of tax and depreciation, to the Treasury and put funds aside for investment (so called investment-refinancing). In so far as depreciation was calculated on a historic rather than a replacement cost basis, so profits were boosted in an inflationary economy. This increased the flow of resources to the Treasury under the 65% rule but reduced the net amount available to firms for investment.

Untransferred profits, dividends and investment refinancing should be added to transferred profits in order to calculate the surplus of the public industrial sector.

Table 6: Gross Surplus of the Public Sector 1970/1 to 1978 (£Em)

	1970/1	1972	1973	1974	1975	1976	1977	1978
1. Transferred profits (1)	101	81	137	188	154	244	348	539
2. Untransferred profits(1)	54	44	74	101	83	131	207	290
3. Investment Financing	87	100	127	150	210	331	268	473
4. Total 1-3	242	225	338	439	447	706	823	1302

Source: 1970/1-1978 K. Ikram Egypt: Economic Management in a Period of Transition P408 Table 11.

- (1) Notes: Untransferred profits equalled 65% of total profits (Ikram) op cit P57-8). Transferred profits calculated as the remaining 35%.

As information on dividends and taxes paid by firms was not available for the whole period, a separate calculation for 1978 is made in Table 9 below

Table 7: Public Economic Sector: Transferred profit by type of activity, 1970/71 to 1979 (£Em)

	<u>1970/1</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>
1.Suez Canal	0	0	0	0	14	46	57	107	148
2.Petroleum Authority	4	2	4	3	18	84	177	192	631
3.Other (1)	97	79	133	185	122	114	149	240	223
of which:									
a) Public Sector Firms	-	-	-	-	-	51	95	166	185
b) Services (2)						63	54	74	37
4.Total of 1+2+3	101	81	137	188	154	244	384	539	1002

Source: Ministry of Finance

- Notes: 1. Before 1976 no breakdown between services and firms available.
2. Includes the Central Bank, agriculture, irrigation, housing, constructions, supply and international trade.

Line 3a of Table 7 above can be broken down by source in order to isolate the profits of the public industrial sector, at least for the years 1976 to 1979. From the table above total profits of public sector firms for the period 1976 to 1979 can be calculated using the 65% rule.

Table 8: Total Profits of Public Sector Companies, 1976 to 1979  
(£Em)

	1976	1977	1978	1979
Profits	78	146	255	285
Increase over previous year %		90	75	12

Source: Table 7, Line 3a above.

The increase in profits from 1976 to 1979 was largely the result of increased profitability in the petroleum sector, which benefited firms as well as the Petroleum Authority.

Returning to the broader concept of the public sector (i.e. including service authorities) the following calculation estimates the net contribution of the sector's surplus in 1978.

Table 9: Estimate of the net Public Sector surplus in 1978 (£Em)

Profits (1)	829	
of which transferred		(539)
untransferred		(290)
Taxes (2)	552	
Dividends (3)	355	
Investment refinancing	473	
Total	2209	
Total less subsidies	2081	

Source: (1) Table 7 Line 4 above

(2 & 3) Public Enterprise Information Centre

Figures for industry were much worse than those for the public sector as a whole. It received £120m of the £128m subsidies allocated in order to cover higher interest payments as interest rates rose.

The final figure in Table 6 above is a financial, one based on prices which existed at the time rather than scarcity ones. Profits of £E338 m<sup>for 1973</sup> compare with those of £E102m reported by the Parliamentary Budget and Plan Committee cited above. It is not clear whether the Committee was referred to transferred or total profits. The profits figure is not however a true guide, the notion of a surplus is a more accurate reflection of the public sector's contribution. Even that ignores the burdens of excess employment and other restrictions which affected publicly owned firms.

### Conclusions

Subsidies in the 1960s were used to increase the purchasing power of the poor in the towns. In the 1970s the system was used to control inflation. As the international price of imported basic foods increased so was the cost of welfare. Allocative efficiency was reduced and inflation was built into the economic system. The Open Door Policy compounded the inflationary problem by increasing the role of imports. It also increased the funds which could be used for misappropriating resources in limited supply.

Pricing policy became the single most important means of government control over the public sector. With the exception of oil, that sector's relative position worsened as increased controls at the end of the decade intensified its managerial problems.

## Chapter 6: Financial Policy

### Introduction

Financial policy had two objectives in the 1970s. The first was to support the development of the economy by providing resources for investment. In so far as planning consisted mainly of investment targets, so financial policy was related to planning mainly via investment. The second purpose of financial policy was to cover a range of current expenditures, in effect supporting consumption. This was the result of a series of political and social policy commitments and finance for these did not fit in closely with any notion of planning.

Investment rose as a share of GDP in the 1970s. Much of this was the result of government action but resources to cover the cost of programmes were often missing. Investment was part of the planning framework but savings were not. The government had great difficulty raising tax revenues, had limited revenues from public sector profits and was therefore forced to raise funds by borrowing, both at home and abroad.

The cost of social commitments to hold down foods prices and those of other basic commodities, increased as the economy became more exposed to international prices. This was a result of government policies. Living costs rose and in order to maintain real purchasing power, the government was forced to increase public sector wages. These went up usually without productivity increases, the latter could not be obtained without changes in the firm which would have entailed, inter alia, more decentralisation than the government wanted. As a result costs rose, feeding an inflationary spiral.

Social commitments increased in cost as the population grew and food production stagnated. The latter was one of the consequences of the lack of investment in agriculture discussed in Chapter 4.

The effects of large scale borrowing were along the lines of financial repression as analysed by McKinnon (1). Borrowing abroad to finance large balance of payments deficits also had significant effects, not least because the availability of foreign funds after 1975 reduced pressures for domestic reform. In this sense the role of foreign assistance was significantly different from that described by Chenery and Strout (2). They suggest that it can increase the supply of funds for investment, supply imports and provide missing skills plus organisational capacities. As well as looking at the nature of financial repression in Egypt, this Chapter will examine the impact of foreign capital in terms of Chenery and Strout's analysis.

Despite the general policy of reducing the state's economic role, public expenditure (on wages, salaries, interest payments, capital items including capital transfers) as a share of GDP rose from 34.8% in 1970 to 54.1% in 1975 and 58% in 1978 (3). The importance of decisions made by the government did not therefore decline in the 1970s despite the change in economic ideology.

In order to illustrate these effects this Chapter will examine the main elements of government expenditure besides investment; subsidies and wages within the context of total expenditure. It will then analyse taxation as a source of revenue before dealing with the effects of government borrowing.

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(1) R. McKinnon 'Money and Capital in Economic Development', Brookings Institution, 1973.

(2) H. Chenery & A. Strout 'Foreign Assistance & Economic Development' American Economic Review, September 1966.

(3) K. Ikram op cit P407-9.

### Policy Options and those chosen in Egypt

The government in a developing country can act in different ways to stimulate development through its spending and fiscal policies. It can run the public sector at a loss in order to subsidise consumers and/or the private sector. The state can try to raise a high level of taxation in order to maximise revenues but its ability to do this depends on its administrative strength plus the willingness and ability of consumers to pay taxes. Tax revenues will be needed to cover the public sector loss unless the government wants to run an overall deficit.

A deficit can be financed from foreign and/or domestic sources. Reliance on the latter can result in a kind of implicit taxation through inflation caused by printing money. The former will have consequences for the balance of payments through loan repayments. An underdeveloped financial system at home makes foreign borrowing more attractive because the latter has less impact on domestic prices and finances imports.

In practice, all these measures were used in Egypt. The public sector, with the exception of oil and the Suez Canal, contributed little to the Treasury in terms of growing revenues. Taxation was linked to expenditure rather than income and so tended to be related to imports rather than domestic growth in nominal terms. Finally, the budget deficit and debt repayments played an increasingly influential role in the economy.



### Financing Investment

Mabro and O'Brien noted that investments in the first year plan were very reliant on imports (1). This remained true in the 1970s. As well as the goods and services used in the investments made, finance was needed and imported on a large scale to fund projects.

The strategy of the Open Door Policy was to attract foreign finance and investment in order to accelerate the rate of economic growth. The fact that this actually occurred was a sign of success, but the failure to increase domestic saving, by more than the rate experienced, posed serious questions of long term viability over government policy. In 1970/1 domestic savings covered about 63% of gross fixed investment, in 1979 it only covered 47%. The growth of investment was only possible because of foreign funds, according to the data presented below in Table 1.

Table 1: The Funding of Investment in % of GDP, 1970/1 to 1979

	<u>1970/1</u>	<u>1971/2</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>
1. Gross Fixed Investment	13.0	12.8	13.1	17.4	27.3	24.1	25.3	27.9	30.4
2.Domestic Savings	8.2	7.9	8.0	5.4	7.3	11.5	14.3	14.2	14.4
3.Foreign Financed Investment	4.8	4.9	5.1	12.0	20.0	12.6	11.0	13.7	16.0

Source: 1970/1 K. Ikram op cit P397

1979 Ministry of Economy op cit P10.

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(1) R. Mabro & P. O'Brien Structural Changes in the Egyptian Economy 1937-65' in M. Cook ed. Studies in the Economic History of the Middle East' Oxford, 1970, P423.

From 1976 some of the funds obtained from abroad were not used, particularly when allocated for projects. The Middle East Economic Digest reported that only 23% of funds allocated for projects by the U.S. Agency for International Development between the US fiscal years 1975 to 1977 had been used. On the other hand 97% of funds allocated for food aid were spent during the same period (1).

Although output growth benefitted after 1975 from the greater availability of foreign exchange, there is evidence that imports of capital goods exceeded the demand for them. A World Bank study, quoted by the Ministry of Economy, stated that a bottleneck in the construction industry meant that output was too low to use all the capital goods imported for it (2). Increased availability of foreign exchange resulted in imports of a speculative nature, anticipating a boom in the construction sector (see section below on financial repression). Low demand, compared with supply was a result of the lack of domestic savings which limited the availability of domestic resources. This is a similar effect to that which limited the use of American project aid (3).

The plans were much more detailed about investment than about savings or finance. The former was seen as the route to economic development, the latter as a constraint to be removed with external assistance. Foreign aid brought problems because its sectoral allocation did not always reflect plan priorities (4). The 1980-84

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(1) M.E.E.D. May 1978 P41.

(2) 'Recent Developments in the Egyptian Economy' Ministry of Economy ESU January 1981, P.22.

(3) Report of the US Controller General 'Egypt's Capacity to absorb and use Economic Assistance Effectively' 1977.

(4) 'Egypt's Development Strategy and Growth Objectives 1980-84' A.R.A. Meguid, P15.

plan, issued in 1979, called for a more careful 'husbanding' of resources. It did not specify how this was to be done (1). It admitted that investment would rely on external finance to a large extent even for covering domestic expenditure.

The failure to meet investment priorities despite increased foreign aid is one of the most significant patterns in Egypt's development in the 1970s. The Open Door Policy helped to encourage an inflow of resources on a scale never previously experienced. Investment targets were continuously adjusted but this process was not coordinated with the pattern of external finance. As well as restrictions imposed by donors, the bureaucracy in Egypt made the flow of funds to priority areas problematic. Vested interests fought for new projects and expansion of existing ones reducing funds for working capital, repairs and other more mundane tasks.

One way around these problems was to encourage private sector activity, this was done to some extent under Law 43 of 1974. As this sector was outside the direct planning framework it is examined briefly in Chapter 7.

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(1) 'Egypt's Development Strategy and Growth Objectives, 1980-84',  
P.40, Ministry of Planning, 1979.

Table 2: Central Government Expenditure by Type, 1975-79  
(Year to 31 December)

£Em	1975	1976	1977	1978	1979
1. Current Expenditure	2416.6	2661.8	3208.8	3488.3	4516.6
(a) of which Wages & salaries	523.7	640.3	791.6	904.1	993.0
(b) of which other purchases of G&S	507.9	564.9	593.3	630.0	762.0
(c) Interest Payments	82.5	99.3	168.5	216.8	462.1
(d) Subsidies & other current transfers	1302.5	1357.3	1655.4	1656.6	2299.3
2. Capital Expenditure	495.9	1111.6	701.9	662.8	1073.8
(a) of which fixed asset purchases	199.0	756.6	353.2	470.2	653.0
(b) Capital Transfers	276.5	271.0	214.7	170.6	396.9
3. Total Lending minus Repayments	314.7	311.8	650.8	914.5	1060.3
4. Grand Total	3227.2	4085.2	4561.4	5083.0	6650.8
<hr/>					
<u>% Shares</u>					
Wages as % Total (1a/4)	16.2	15.7	17.3	17.7	14.9
Subsidies (1d/4)	40.4	33.2	36.3	32.6	34.6
Current (1/4)	74.9	65.2	70.3	68.6	67.9
Capital (2/4)	15.4	27.2	15.4	13.0	16.1
Fixed Asset Purchases (2a/4)	6.2	18.5	7.7	9.2	9.8

Sources: Government Financial Statistics Yearbook 1982. Vol VI IMF

### Subsidies

One of the most important reasons why the budget deficit grew in the mid 1970s was the continuing need to provide basic food and a range of other commodities to the mass of the population at fixed prices. These had, to some extent, to be imported at a time of increasing international prices. Fixed domestic prices encouraged the consumption of a growing population.

They were originally introduced on a small scale in the 1960s for a narrow range of essential goods and services. The specific aim of the policy was social; to help the poor, but the whole population stood to gain from such a system, at least in terms of short run consumption needs. In 1960 the total cost came to £E9m, a small and manageable amount (1). Until 1965 Egypt received considerable food aid from the USA and so no short term balance of payments problems resulted.

Table 3: Net Losses of the General Authority for Supply Commodities 1973-1978, £Em.

1973	1974	1975	1976	1977	1978
89.0	330.1	408.7	250.2	330.6*	423.1*

Source: K. Ikram op cit P336

Note: \*Part of the losses in 1977 and 1978 were due to the move from the higher official to the lower parallel exchange rate.  
In addition to these direct subsidies, there were others for industry, agriculture (see Chapter 4) and private consumers. are included in Table 4.

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(1) K. Ikram P327.

Subsidies had a macro-economic impact in that they required funding. This section will attempt to indicate some of the costs incurred. Many subsidies were covered by the accounts of the General Authority for Supply Commodities, which made losses on the sale of wheat, flour, maize, edible fats, rationed oils, sugar and other items. It made small profits on sales of unrationed edible oils, unrationed sugar, tea, cotton, seed and other items. The net position is shown in Table 3.

Table 4: Total Direct Subsidies paid by the Government 1973-1980/1  
£Em.

1973	1974	1975	1976	1977	1978	1979	1980*	1980/1*
131	410	622	434	650	710	1288	1269	1556

Sources: 1974-7 K. Ikram op cit P321  
 1980 and 1980/1 Budgets: CBE Annual Report January-June 1980  
 P32  
 1978-9 The Impact of the Elimination of Subsidies on  
 the C.O.L. of Egypt's Urban Population, K. Korayen  
 Cairo Papers in Social Science, Vol.5 No.2 April 1982  
 P70.

Note: \*Budget proposals for 1980 and then newly defied financial year 1980/1.

Another group of subsidies were paid to industry for specific reasons such as compensation for freezes on their output prices. These had to cover increased interest costs when interest rates were put up. These rose from £Elm in 1974 to £El20 in 1978 (1). Subsidies as a share of the total budget deficit were 1.5% in 1970/71, 50.4% in 1974 and 34% in 1978 (2).

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(1) Public Enterprise Information Centre

(2) K. Ikram op cit P406-7

Subsidies helped to create demand for some commodities in the economy but the pricing policy of which they were a part did not encourage the growth of supply in the economy to meet demand. As a result inflation, shortages and imports increased.

The problem of inflation has been closely related to the growth of subsidies. Demand was stimulated as a result of subsidies, for example, automobiles, a luxury in a country with Egypt's per capita GNP, have been subsidised. The domestically produced car itself, petrol and parking have all been subsidised. Income inequality permits demand for such goods. As a result, the demand for, and use of, cars has produced massive congestion in Cairo which, in turn, has created a 'need' for new investment in roads, bridge and related items, none of which contributes to the social welfare of the mass of the population in urban or rural areas. Subsidies on cars are perhaps the most dramatic example of the way in which the authorities have failed to select strategic products for assistance. Their failure in this instance had led to the development of a range of motorcar related demands. There have been beneficiaries, but they have not been in the group most in need of government help (1).

The implicit energy subsidy did not enter the government's account because it did not involve actual transfer payments. Waterbury (2) has estimated the value of the subsidy on petrol to have been £E206m in 1976, £E310m in 1977 and £E867m in 1980. In 1980 the

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(1) Ministry of the Economy, op cit, P109.

(2) 'The Egypt of Nasser & Sadat' J. Waterbury, Princeton University Press, 1983.

subsidies on bottled gas and high octane fuel came to an additional £E101m. Ikram estimated the implicit subsidy on all fuels in 1978 at £E427 (1) and the Ministry of Economy's (2) estimate for 1979 was £E1312m. These represented a growing proportion of national income if the latter is measured at existing prices (i.e. domestic energy prices at about 20% of their international level).

Table 5: Implicit Subsidy as a Share of GDP 1976-1980 (%)

1976	4.9 (petrol only)
1977	6.3 (petrol only)
1978	<u>4.4</u> (all fuels)
1979	10.5 (all fuels)
1980	<u>5.8</u> (Petrol, gas and octane)

Sources: Waterbury, Ikram & E.S.U. cited above and International Financial Statistics, IMF 1978 and 1983.

If energy prices in the economy had been equal to international ones then the GDP would have been higher. If these figures are added to declared subsidies, then their share in national income was:

Table 6: Direct & Implicit Subsidies as share of GDP (%)

1976	10.2 (petrol only)
1977	11.7 (petrol only)
1978	<u>11.6</u> (all fuels)
1979	20.8 (all fuels)
1980	<u>13.3</u> (petrol, gas & octane)

Sources: Tables 4 & 5.

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(1) K. Ikram 'Egypt: Economic Management in a Period of Transition' John Hopkins University Press, 1980, P.280.

(2) 'Recent Developments in the Egyptian Economy', Ministry of Economy Economic Studies Unit, January 1981, P.15.



This problem has been recognised at the official level by the Economic Studies Units at the Ministry of Economy. They stated that the adjustment of relative prices contributes, in the short run, to inflation, but in the longer term, the correct (or market) price increases the economy's ability to adjust to changing demand, reduces bottlenecks and hence contributes to lower inflation (1)

Domestic output has not increased commensurately and an increased balance of payments deficit has resulted. The problem of inflation is not only related to aggregate expenditure on subsidies, but also to the structural effects of implicit subsidies. These are designed to hold prices at a particular level. The producer therefore has no incentive to increase his production to meet any excess demand and therefore will not necessarily take steps to increase efficiency.

### Wages

The second major element of the government's current budget was wage and salary costs. Frequent changes in the way in which budget data were calculated and presented make time series comparisons problematic. Table 2 shows that wages took about one fifth of the budget at the beginning and end of the decade. Together with other 'current expenses' they accounted for 73.2% in 1970/1 and 67% in 1980/1. This contraction permitted an increase in investment although borrowing continued to underpin the budget.

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(1) Op cit P61.

Table 8 gives a breakdown of the public sector wage bill. The trend was for growth considerably in excess of inflation as measured by the consumer price index. The absolute burden increased because of the expansion of the bureaucracy analysed in Chapter 2. The civil service wage bill grew at a faster rate from the middle of the decade as it took the burden of supplying jobs of which the public industrial sector had been partly relieved. Table 7 shows that wages in administration grew much more slowly than in agriculture, a sector in which market forces operated to a much greater extent (1). In so far as the government had more applicants than it needed so it did not need to pay high wages. This was the limited extent to which market forces operated in the public labour market. This did not prevent continuous increases in wages designed to match rising prices.

Table 7: Wages in Agriculture and Government Administration

Average wage 1966 = 100.

	Agriculture, men Average daily wage	Government Administration
1970	99.9	101.9
1971	99.9	100.6
1972	103.4	103.4
1973	111.6	110.2
1974	138.9	107.8
1975	182.2	115.0
1976	239.2	129.4
1977	298.2	147.8
1978	345.4	159.6
1979	411.7	171.8

Source: B. Hansen & S. Radwan, 'Employment Opportunities and Equity in a Changing Society: Egypt in the 1980s', P71, International Labour Office, 1982.

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(1) B. Hansen & S. Radwan, op cit.

Table 8: Expenditure in the State Budget on Wages 1970/1 - 1980/1  
(£Em)

	Central Government	Local Government	Service Authorities	Economic Authorities	Total
1970/1		296.1	78.2	54.5	419(1)
1971/2		313.4	82.8	49.7	446.9(1)
1973		361.1	131.7	97.3	540.1(1)
1974		397.3	147.2	52.5	597.5(2)
1975	219	252	76.8	104.4	652.2
1976	252.2	297.1	90.9	128	768.2
1977	336.3	343.0	107.4	151	937.7
1078	369	402	120.0	173	1065
1979	379.9	529.5	148	200.4	1257.8
1980	606	592	147	288	1633
1980/1	783	596	148	(3)	

Sources: 1970/1 & 1971/2, CBE Economic Review Vo. XI No.4, 1971

1973 - 1977, NBE Economic Review various editions.

1978 - 1980/1, CBE Economic Review & Annual Reports  
various.

Notes: (1) Includes £E0.5m special fund

(2) Includes E£0.1m special fund

(3) Economic Authorities spending excluded from state budget  
under new presentation from 1980/1.

### Government Revenues

The share of central government revenue in GDP rose from 16.2% in 1974 to 23.6% in 1978 (1). This was mainly due to increased taxes on foreign trade. These rose as a share of GDP but increased exemptions meant that they actually fell as a share of imports at the end of the decade. As imports rose in relation to GDP this went largely unnoticed. The devaluation of the Egyptian Pound added to the local cost of importing and thus to tax revenues. Imports rose in large part because private consumption did and so the government revenue base relied on an unhealthy balance of payments deficit.

Revenues from the public sector activities were limited by the policies followed with regard to pricing. In 1970/71 total public sector profits were £E101m. Of these £E4m came from the Suez Canal and none from petroleum. In 1979 the total was £E1002m, of which £E779m came from sources in the Suez Canal and petroleum (Table <sup>Chapter 5</sup> 7). Profits from industry rose by 130% over the period but prices as measured by the consumer price index increased by about 110%. The annual increase in profits was therefore about 2%, according to the official index which understated the true rise in prices.

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(1) K. Ikram, 'Egypt: Economic Management in a Period of Transition', P324.

Table 9: Government Revenues 1969/70 - 1978 (£Em)

	<u>1969/70</u>	<u>1970/1</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
Total	750	869	903	1018	1184	1524	2015	2755	3306
of which									
Cent.Gov.	658	726	745	830	968	1222	1595	2373	2672
of which									
(i) Tax	524	564	584	616	683	948	1251	1876	2034
(ii) Transf.									
Profits	40	101	81	137	188	154	243	384	539
(iii) Other									
non-tax	94	61	80	78	97	120	101	113	119
Investment									
Self financing	36	87	100	127	150	210	331	268	473
Local Gov.									
Revenues	56	56	58	60	66	92	89	114	141

Source: K. Ikram, 'Egypt' Economic Management in a Period of Transition, op cit P409.

Table 10: Sources of Tax Revenue, 1970/1 - 1978 (£Em)

	<u>1970/1</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
Personal Income	28.2	25.9	32.3	33	31	48	55	52
Business Profit	115.3	120.2	128.5	143	195	277	387	538
Goods & Services	166.0	181.2	190.7	195	229	284	340	360
Foreign Trade (inc. Customs duties)	196.3	193.7	205.7	231	400	538	979	920
Property	19.2	23.8	16.7	21	30	19	18	23
Other	39.4	38.7	92.7	59	63	86	97	141

Source: K. Ikram op cit 1974-78, P319.  
1970/1-73, P411.

### Taxation

Increased tax revenues, resulting from higher import volumes, indicate how unplanned the revenue gain was and how transitory its duration might be.

Other sources of taxation performed much less well. Taxes on personal incomes actually fell from 0.8% of GDP in 1974 to 0.6% in 1978. They also fell as a share of total tax revenue from 4.8% in 1970/71 to 3.8% in 1977 (1). Two points are significant here. Firstly, in a nominally socialist country, which Egypt was, even in 1974, the level of income tax levied was extremely low. The effectiveness of the collection mechanism was weak. Both the rates of tax and administrative weaknesses gave Egypt's socialism a vague and shadowy nature. Secondly, little was done to increase revenues in a period of growth. This might be expected to some extent in a climate of partial laissez faire, but to have permitted the share of GDP collected in income tax to fall from such a low base as 0.8% in 1974, suggested that the government's laxity was almost deliberate.

The same argument applies to taxes on property which could have increased their yield with the boom in land prices and urban construction, particularly of housing for the wealthier. The only other tax revenue to increase in revenue between 1974 and 1978 was the

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(1) M. Reda A. El-Edel 'The impact of Taxation on Income Distribution: An Exploratory attempt to estimate Tax Incidence in Egypt' in G. Abdel Khaled & R. Tignor eds. 'The Political Economy of Income Distribution in Egypt'

business profits tax. This was a result of oil export growth and the reopening of the Suez Canal (1). Reliance on indirect taxation increased. In 1978 these brought in a total of £E1,280m, compared to the £E52m from personal income tax and £E528m from the business profits tax (2).

Price differences, which formed an important source of government revenue, did not show up directly on all fiscal accounts. This was because they represented the difference between buying and selling prices and formed parts of the government's trading activities. In 1976, they came to £E185.5m, 16.1% of total tax revenue (3).

A move towards greater reliance on indirect tax had its origins under Nasser. According to Abdel Fadil, indirect taxes and price differences (equivalent to a tax) on 'wage goods' increased faster than those on consumer durables (4). It was therefore easy for President Sadat's governments to follow the same trend and allow the increase in imports to finance government expenditures. If the socialist inclined Nasser adopted an inegalitarian tax and pricing policy, then the less socialist Sadat would not be betraying the nation's inheritance if he maintained or intensified those trends.

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(1) K. Ikram, op cit, P318-320.

(2) K. Ikram, op cit, P319.

(3) Ministry of Finance, Financial Accounts Report for 1976 quoted on P42 of A. Mohie-Edin Urban Income Distribution, September 1980, draft.

(4) M. Abdel Fadil, 'The Political Economy of Nasserism', Cambridge University Press, 1980.

The 1980/81 budget contained a statement that the burden of indirect taxes adversely affected the welfare of the poor and 'contradicts the philosophy of the new era'. It went on to state that tax laws would be reviewed with special attention given to the situation of both rich and poor (1). That such a statement was made is significant, given the large disparities of wealth and income which have developed over recent years. In terms of understanding the decision making process and the influences on it, it is necessary to find out why so little was done to shift burdens from the poor to the rich.

A simple answer is that the government, or the regime, represented those who had a vested interest in the status quo, or that they were synonymous with those groups. Another explanation is that the administrative machinery was too weak for effective taxation of income and wealth. Alternatively, low taxation of the rich may be seen as a means of providing incentives in the economy.

It is not necessary to go as far as Kaldor does in order to justify higher taxation than that which prevailed in Egypt in the 1970s. Kaldor argued that taxation is an important way of increasing savings in the economy, in that it reduces consumption. This is needed in order to finance the infrastructure. The need to use taxation is reinforced by the weakness of the banking system as a means of mobilising resources in many developing countries (2). Even if these developmental reasons are ignored, there are socio-economic reasons for spreading the burden of taxation.

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(1) Memorandum regarding the main features of the draft State General Budget of Fiscal Year 1980-1981, Ministry of Finance (English).

(2) N. Kaldor 'Taxation for Economic Development' Journal of Modern African Studies, Vo.I No.1, 1963.



### Government Borrowing and its Effects

As well as having a weak tax collection system, the government increasingly relied on borrowing to cover its expenditure. The under-developed state of the banking system meant that, among other things, finance was not available to all sectors of the economy. According to Mckinnon (1), financial repression is a situation in which small borrowers, particularly in rural areas, do not get the same access to finance as favoured ones; the latter usually in urban areas. The former rely on local money lenders and others who charge high interest rates. In Egypt this situation was compounded by ceilings on interest rates which meant that savers were offered a negative return on local currency deposits. Furthermore, the government pre-empted much of the credit available by its own borrowings.

The overall fiscal deficit rose sharply in the 1970s (see Tables 12 & 13). This is a reflection of the largely unplanned nature of government finance.

Table 13 shows that the share of the central government's deficit financed by the central bank ('monetary authorities') grew from 13% in 1975 to 67% in 1979. It also shows the importance of short term loans and advances. As a share of domestic borrowing they were 31.6% in 1975 and 84.7% in 1979.

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(1) R. Mckinnon 'Money and Capital in Economic Development',  
Brookings Institution, 1973.

This huge growth of borrowing was a reflection of the shallowness of the financial system. As Table 13 shows, the long term bond market was of minimal significance. According to Kassem (1), much of the borrowing from deposit money banks represented government borrowing via state banks to finance the deficits of public sector companies. The willingness to fund these deficits is an example of the favouritism which McKinnon identifies with financial repression. The alternatives were either to close bankrupt state companies or completely reorganise their financial, pricing and employment systems.

Krueger has attempted to quantify the gains made by firms receiving what McKinnon called 'favouritism'. She estimated that, with 20.3 billion Rupees of credit outstanding in India, rent of 407 million Rupees was received because interest rates paid were 2% lower than those which would clear the market (2). Her calculation was based on an estimated market clearing rate of 8%.

It is not possible to calculate a market clearing rate for Egypt but it is clear that actual rates were below the market clearing levels. Although interest rates have risen in Egypt they have not fully responded to market pressures and failed to offer a real return on domestic currency deposits for most of the decade. (Inflation was higher than shown in Table 9).

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- (1) O. Kassem 'Financial Repression in the Egyptian Economy' P3, Draft.
- (2) A.O. Krueger, 'The Political Economy of the Rent Seeking Society', American Economic Review, July, 1974.

If domestic borrowers received an implicit 2% subsidy then their gain amounted to £E9m in 1975 and £E31m in 1979 (based on total debt financed domestically)(1). If the subsidy was 5% then they gained £E23m and £E78m respectively.

In so far as borrowing was forced on firms by their inability to charge market prices for their products while having to pay centrally regulated wages and salaries, so the interest rate subsidy amounted to a partial compensation for losses forced on them.

From 1971 to 1978 central bank claims on the government and commercial banks grew at an increasing rate practically every year. There was a slowdown in 1979 and 1980 but net claims on the government as a share of total domestic credit grew from 68.4% on average between 1970 and 1974 to 69.8% between 1975 and 1980 (2). This caused a large scale growth in the money supply.

Liquidity, defined by M2 or M3 grew much more rapidly than the national income in nominal terms. According to Friedman and Schwartz (3) the growth of M2 can be partitioned into three elements. The first is central bank liability growth, controlled by the government and referred to as the monetary base: B.

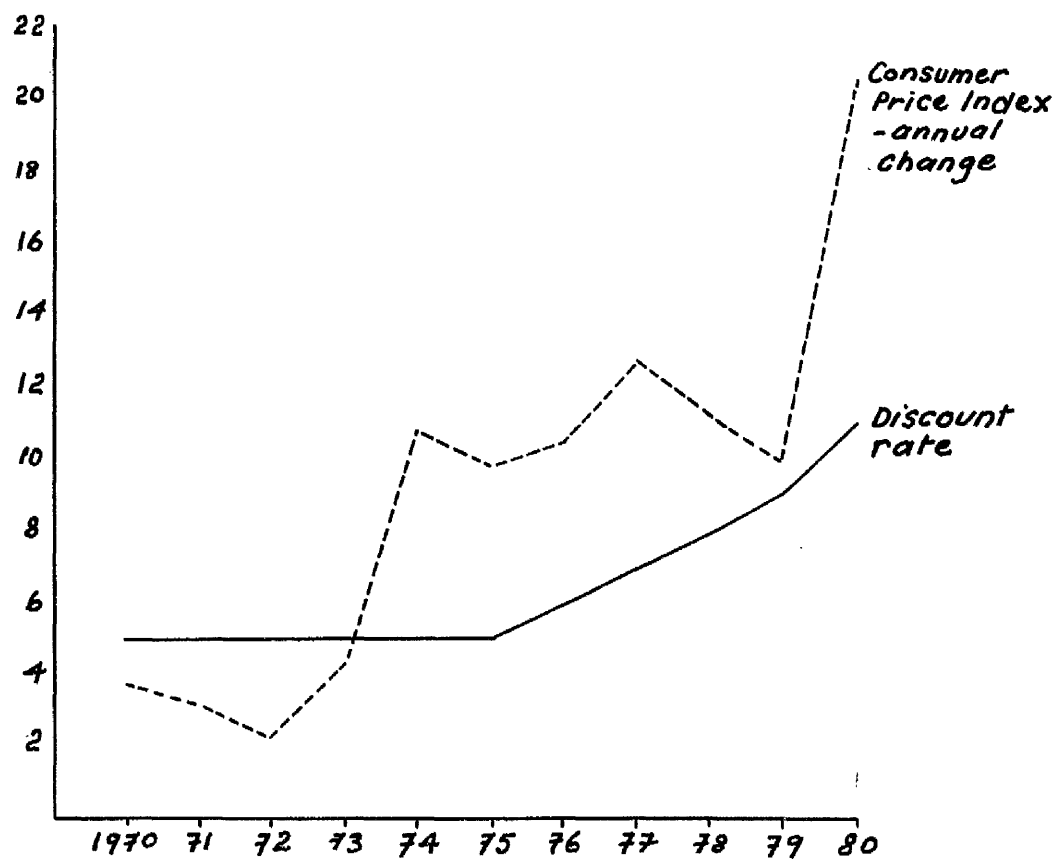
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(1) Table 13.

(2) International Financial Statistics 1981 Yearbook, IMF.

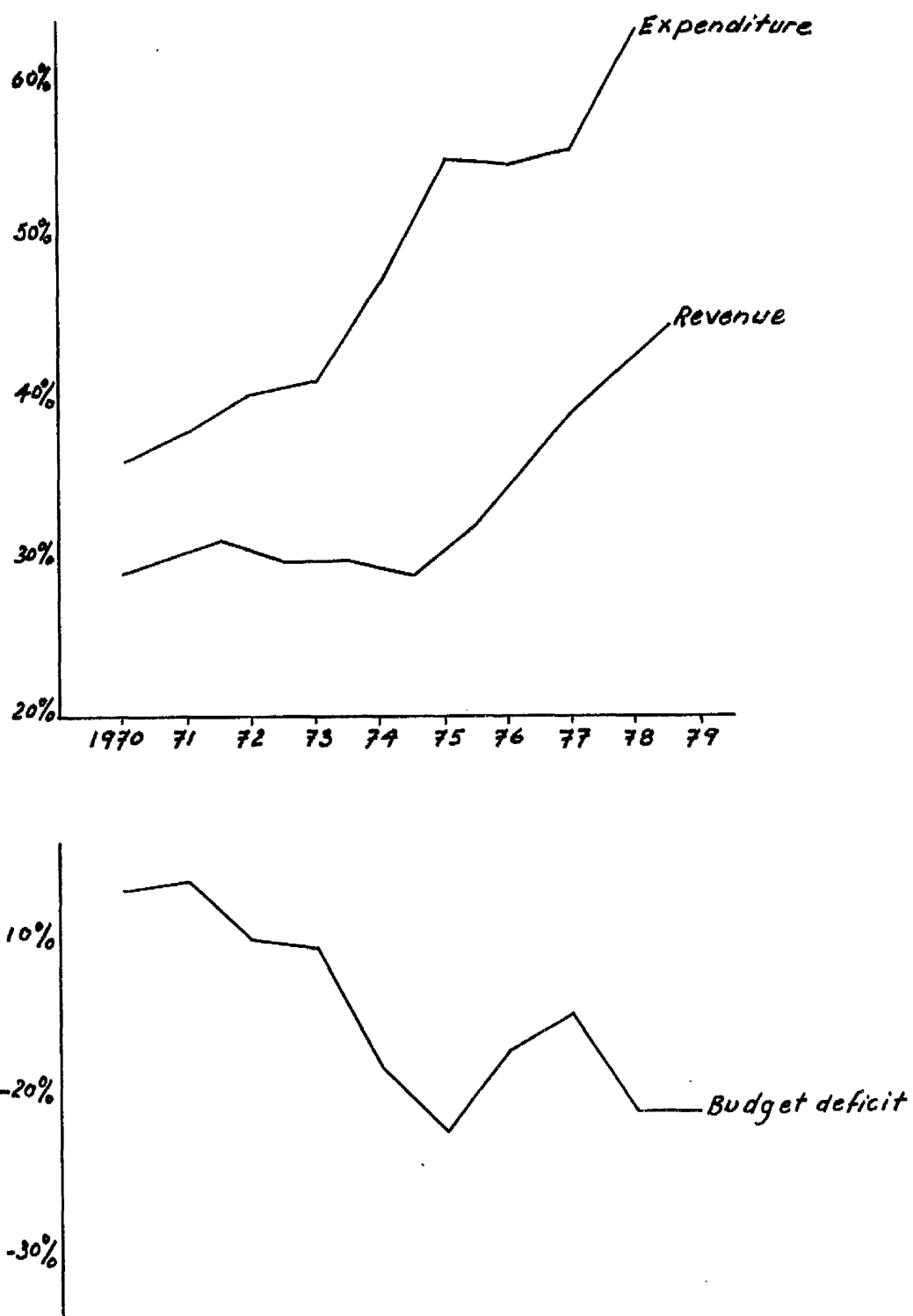
(3) M. Friedman & A. Schwartz A Monetary History of the US 1879 - 1960, Princeton University Press, 1963.

**TABLE 11: INFLATION AND THE RATE OF INTEREST 1970-1980**



**SOURCE: International Financial Statistics, IMF 1978 & 1983**

**TABLE 12: GOVERNMENT EXPENDITURE, REVENUE AND THE BUDGET DEFICIT AS % OF GDP 1970-1979**



SOURCE: K. Ikram "Egypt: Economic Management in a Period of Transition" p.p. 406-7 + 409-11

Table 13: Financing the Central Government's Deficit, 1975-1979  
(£Em)

	1975	1976	1977	1978	1979
<u>1. By Type of Debt Holder</u>					
Total Deficit	938.4	1556.8	1113.6	1245.6	1964.3
(i) Financed Abroad	477.2	639.7	525.7	300.7	397.0
(ii) Financed at Home	461.2	917.1	587.9	944.9	1567.3
by (a) Monetary Authorities	125.0	125.0	400.0	517.1	1321.4
(b) Deposit Money Banks	183.1	232.0	59.8	408.6	156.7
(c) Other	153.1	560.1	128.1	19.2	89.2
<u>2. By Debt Instrument</u> (Domestic Finance)					
(i) Long term bonds	72.1	75.7	8.0	-	36.4
(ii) Long term loans	56.3	74.4	73.2	381.0	203.3
(iii) Short term loans & advances	145.6	177.3	437.0	521.0	1327.6
(vi) Other	187.2	589.7	68.9	42.9	-

Source: IMF Government Financial Statistics Yearbook, Vol.IV, 1982

The public's preference for holding cash as opposed to deposits and the bank's reserve ratio are the other elements. Kassem (1) has shown that B explained 33% of the growth of M2 in 1971. The rest was due to increased bank lending. In 1972-74 B explained 70 to 109% of the change in M2, with the reserve ratio having a negative role. In 1975 B and the reserve ratio had about equal roles as the government reduced the latter. In 1976 the reserve ratio was increased and in 1977 it was cut again. B dominated the rise in M2 in 1976 and in 1978 with the reserve ratio playing an important role in 1977. The public's cash reference had a marginal role. From 1976, rising interest rates increased demand for savings deposits and reduced cash preference. The shares of M2 are given in Table 14.

Although the role of savings accounts (or term deposits) rose by 12.1% of M2 between 1970 and 1980 they did not play as big a part as Mckinnon would advocate for successful monetary development. In what he describes as the successful case of Korea, savings accounts increased from 21% of M2 in 1960 to 65.7% in 1970 (2). This suggests that increased monetarisation of the economy - the ratio of M1 or M2 to GDP - is not a sufficient guide to the quality of development. The ratio of M2 to GNP in Egypt rose from 35% in 1970 to 54% in 1980, compared to 56% in the UK in 1970 and 29% in Argentina in 1970 (3). This suggests Egyptian progress in monetarising the economy

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(1) O. Kassem op cit

(2) R. Mckinnon, op cit, P109

(3) Figures on Egypt from Ministry of Economy op cit and those on UK and Argentina from Mckinnon op cit.

but the nature of that process is clearly important. Much of it was due to the expansion of foreign currency deposits. These played an increased role in M2, particularly in savings accounts. The growth of domestic currency savings accounts was therefore more limited than the figures in Table 14 suggest. As dollar interest rates rose in the late 1970, so foreign currency accounts became more attractive, given the protection they afforded against devaluation and the unattractive interest rates obtainable on local currency deposits. The share of foreign currency in M2 was 14.4% in 1978, 17.9% in 1979 and 20% in June 1980. Its share in savings accounts was 15.5% in 1978, 28.8% in 1979 and 37.5% in June 1980 (1).

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(1) Ministry of Economy op cit, P91.



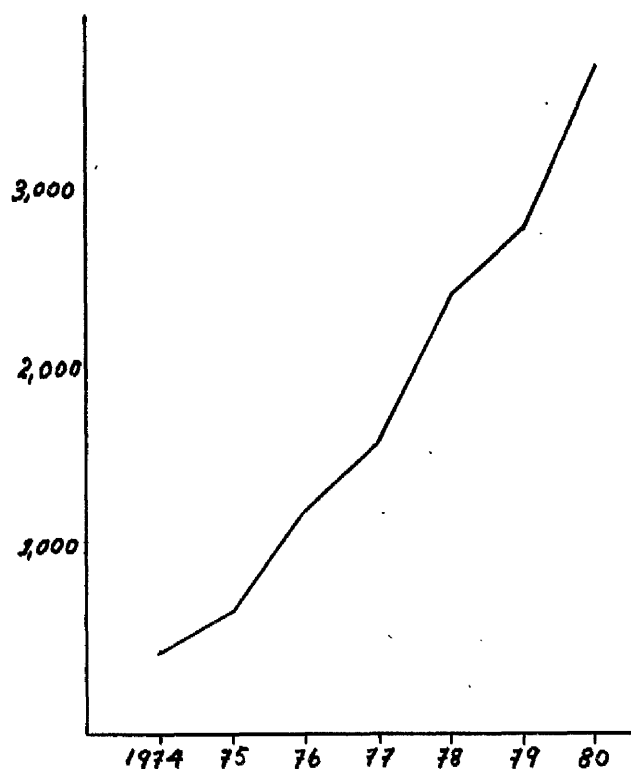
Table 14: Shares in M2, 1970-1980 (%) Year End

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
1. Currency	50.0	51.6	50.3	50.6	47.4	47.6	45.3	42.6	42.0	38.8	37.4
2. Demand Deposits	24.5	26.4	28.5	27.9	27.7	29.0	27.8	29.1	26.2	25.0	24.9
3. Savings Deposits	25.5	22.0	21.2	21.5	24.9	23.4	26.9	28.3	31.8	36.2	37.7
4. (1) Foreign Currency									49.0	47.2	47.0
(2) Foreign Currency									19.6	20.8	23.7
(3) Foreign Currency									31.4	32.0	28.5

Source: ESU 'Recent Developments in the Egyptian Economy, January '81.

(1) 1980 = June.

**TABLE 15: REMITTANCES AND TOURIST REVENUES**  
**\$m 1974-1980**



**SOURCE:** "Recent Developments in the Egyptian Economy"  
Ministry of Economy E.S.U January 1981 p.p. 67-95  
1980 estimated from first half figures

The heavy, though declining, dominance of currency, shown in Table 14 is the opposite pattern from that which would be expected in a developed economy. Low or even negative interest rates discouraged savers from using deposit accounts denominated in local currency. Commercial banks were unwilling and/or unable to lend on a large scale to private sector industry and on a commercial (i.e. undirected) basis to the public sector, for two reasons (1). Firstly, the finance available was limited by unattractive interest rates and secondly, the government pre-empted resources. This was done by inflationary deficit financing which reduced real incomes. The Banks were state controlled and so the instructions received from government were mandatory. The expansion of the monetary base took the form of central bank lending to the government and to the commercial banks. Both of these sets of loans supported the debt of the government and the public sector.

According to the Ministry of Economy , central bank borrowing by the government increased much faster than M1 (2). Part of the government's expenditures went on imports of basic foodstuffs and other commodities. This meant that the borrowing used to buy foreign exchange did not result in an increase in the money supply. The sale of basic commodities by the government withdrew funds from the economy, although in smaller quantities than their sales without subsidies would.

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(1) Ministry of Economy, op cit, P42.

(2) Ministry of Economy, op cit, P41.

The expansion of liquidity took place against a background of price controls and shortages. As a result, liquid balances accumulated which encourage imports, black market activities, property plus other speculation and an outflow of capital (1).

Table 17 shows how foreign currency contributed to the apparent monetarisation of the economy between 1978 and 1980. (Data is not available for the period before 1978). M2, as a share of GDP, rose between 1970 and 1978 but it fell between 1978 and 1980 (by 5%). M2 minus foreign exchange (held in current accounts and deposit accounts) also reduced the share of M2 in GDP by 7.7% in 1978, 9.8% in 1979 and 9.7% in 1980.

Table 16: Increases in Real Balances 1978-9 and 1979-80

	<u>Dec 1978-Dec 1979</u>	<u>Dec 1979-Dec 1980</u>
1. Current Accounts		
- CPI Deflator	13.3	-0.2
- GDP Deflator	1.7	
2. Current A/Cs Minus Foreign Currency		
- CPI Deflator	20.7	10.7
- GDP Deflator	8.3	
3. Savings Accounts		
- CPI Deflator	34.7	4.5
- GDP Deflator	20.9	
4. Savings A/Cs minus Foreign Currency		
- CPI Deflator	16.2	9.2
- GDP Deflator	4.3	

Source: Ministry of Economy.

Foreign exchange in current accounts fell by 10.8% and that in savings rose by 167.7% in nominal terms between 1979 and 1980 (December to June)

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1) Ministry of Economy, op cit P.46.

Table 17: M1 &amp; M2 Minus Foreign Currency as % GDP, 1970-1980

	Dec 1970	Dec 1978	Dec 1979	Jun 1980
<u>Components of M2</u>				
Current A/c/GDP	8.7	13.9	13.6	12.0
Savings A/c/GDP	9.1	16.9	19.7	18.1
Currency/GDP	17.7	22.3	21.1	18.0
M1/GDP	26.4	36.2	34.7	30.0
M2/GDP	35.5	53.1	54.4	48.1
<u>M2 - Minus Foreign</u>				
<u>Currency</u>				
Current A/c/GDP		8.9	9.4	9.1
Savings A/c/GDP		14.3	14.2	11.3
M1/GDP		31.3	30.3	27.1
M2/GDP		45.4	44.6	38.4

Sources: Monetary Data: Ministry of Economy 'Recent Developments in the Egyptian Economy', E.S.U. op cit P31,36 & 91.

GDP: International Financial Statistics, IMF.

The Ministry of Economy suggest that emigrant remittances, tourist revenues and payments in foreign currency by foreign residents in Egypt were major sources of foreign exchange which eventually went into bank accounts. Table 15 shows how dramatically the most important of these items grew.

The devaluation of the Egyptian Pound (see Chapter 7) increased the local currency value of foreign exchange so that the effect of bank holdings, measured in Egyptian Pounds, was even greater than Table 15 indicates. As these funds were concentrated in savings accounts, so the latter increased as a share of M2.

The value of real balances was affected by the way in which inflation is measured. Given that the consumer price index (CPI) understated the actual inflation rate, so the true increase in real balances cannot be measured exactly.

In most years the GDP deflator was close to the CPI but in 1978-9 it was 22.4% compared to a CPI increase of 9.9% (1). Both deflators have been used in the table below for the period 1978-9.

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(1) Ministry of Economy, op cit, P31.

The effects of inflation cannot be so easily and precisely predicted because some will be able to escape it by increasing their prices or earnings. Other will not, but who forms the two groups of 'gainers' and 'losers' is not easily calculable. It therefore represents an 'implicit', rather than 'explicit' way of dealing with a problem (1).

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- (1) In a conference in 1973, this issue came up in a different context. Jacob Arnon, former Director General of the Israeli Finance Ministry, discussed some advice which he and Professor D. Patinkin had given, years before, to the then Minister of Finance. The latter, wanting to build a factory, suggested that money be printed to cover the costs of the project. Arnon reported that Patinkin replied as follows: If the money was printed, then the factory could be built, a visible sign of success for economic policy. It would also result in 'houses without doors and windows' over time, as inflation resulted. Jacob Arnon, in a symposium on The Economist's Task in the Economy, P22, Issues in the Economy of Israel, ed, H. Halevi and Y. Kop Maurice Falk Institute for Economic Research in Israel, 1975.

The political impact, in the short run, of building a new factory may be considerable, but the impact over a longer period of time of inflation, can be more serious, as the events of 1977 and 1980, in Egypt, show. The inflationary process, if it is used in the way described above, is a means of delaying the making of choices in an explicit way and forcing those choices onto the economy implicitly.

### Foreign Sector Implications

The low level of domestic savings meant that investment had to be financed abroad to an increasing extent. The corollary of low savings was high consumption, something which in turn led to a growth of imports.

Table 18: Foreign Trade as a Share of GDP, 1960/71-1979 (%)

	1970/1	1971/2	1973	1974	1975	1976	1977	1978	1979
Share of Exports(1)	14.0	13.3	14.0	21.2	19.5	19.6	19.2	17.1	24.6
Share of Imports(2)	18.7	18.2	19.1	33.2	39.5	32.3	30.1	30.7	39.8
Trade Balance share	4.7	4.9	2.1	12.0	20.0	12.7	10.9	13.6	15.2

Sources: 1970/1-1978: K. Ikram, 'Egypt: Economic Management in a Period of Transition' Table 5 Statistical Appendix.

1979: ESU 'Recent Development in the Egyptian Economy' US Embassy Cairo 'Economic Trends' January 1981.

Notes: 1. Goods and Services  
2. Derived from export and import figures.

The liberalisation was mainly confined to the foreign sector; imports became much less restricted and the exchange rate system was rationalised. The number of exchange rates was reduced and more trade was carried out at rates corresponding to market rates (see Table 1, Chapter 7). The net effect was an increase in imports as the system controlling their entry into the economy was liberalised. The other element was increased access to foreign exchange, from 1976.



### Savings

Although savings increased as a share of national income in the 1970, according to the Ministry of Economy, the savings rate was below that of other countries with similar levels of per capita income (1). The Ministry suggested that the lack of savings has limited the volume of domestic resources available for investment. The savings ratio (savings as percentage of GDP) fell between 1978 and 1979 (2). Ikram also noted a small fall in the ratio between 1977 and 1978 (3).

The unsatisfactory performance of savings, either by individuals or public and private sector firms, has meant that the government, with its weak tax collection system, had to force involuntary savings in the economy. This was done by borrowing and by inflation. The latter represents an unplanned means of obtaining resources, because the real expenditure which inflation prevents, cannot easily be predicted. If the government sets a certain tax, then it can make calculations about the revenue which will be generated and about the expenditures which will be displaced by the tax. Printing money to cover part, or all, of a budget deficit caused inflation.

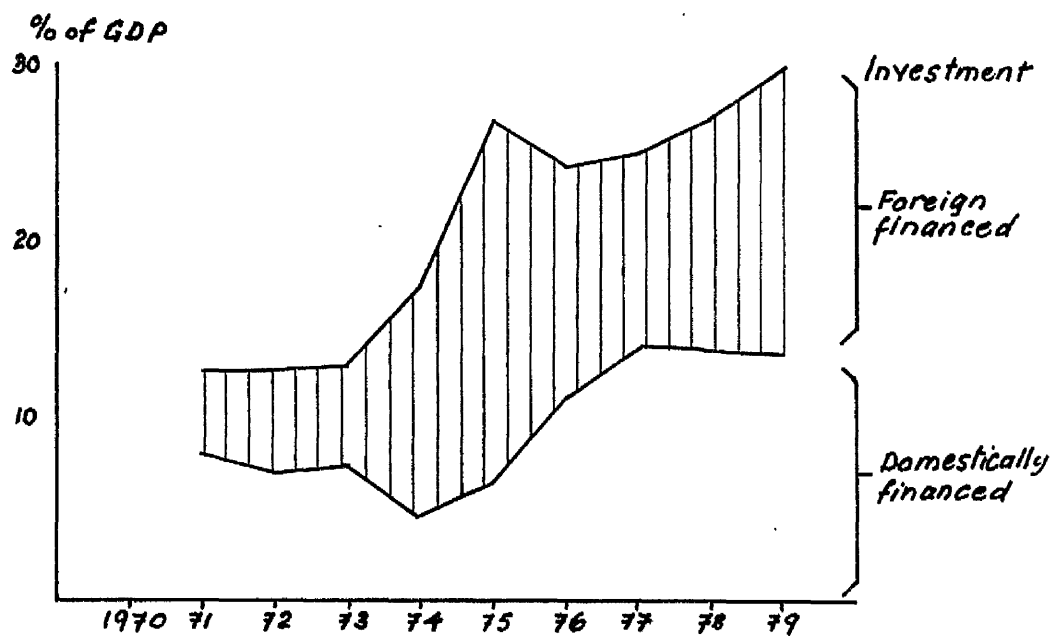
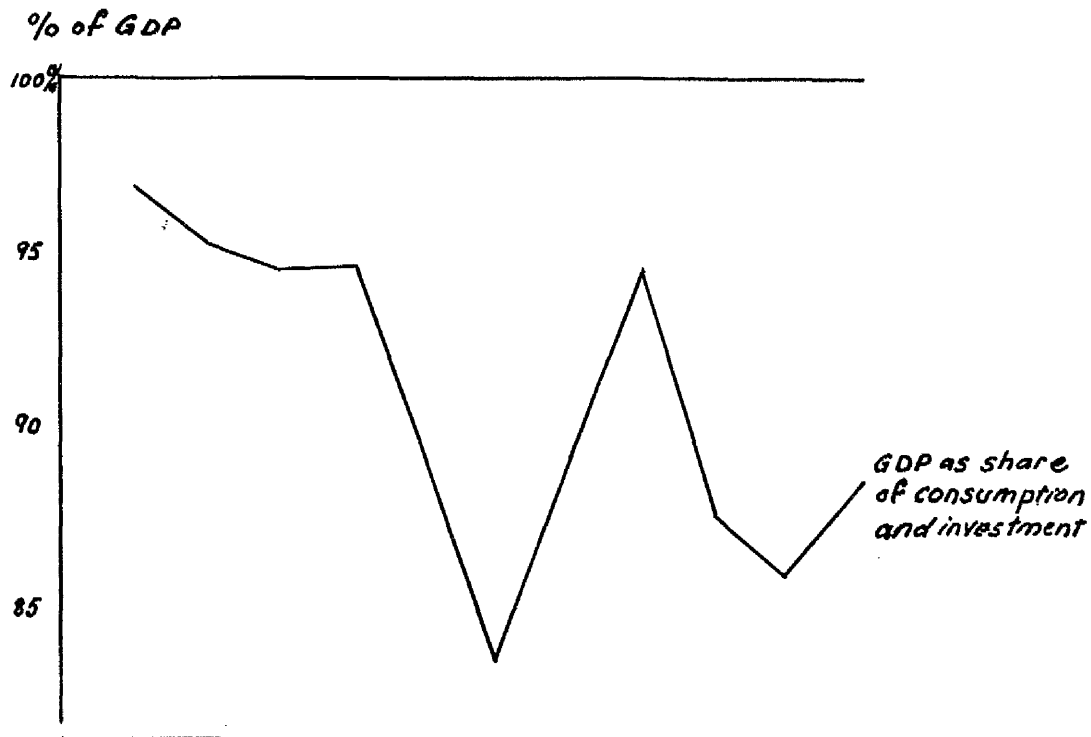
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- (1) Ministry of Economy, Economic Studies Unit 'Recent Developments in the Egyptian Economy' P23.
  - (2) Ibid, P10, calculated from GDP at market prices.
  - (3) K. Ikram, 'Egypt: Economic Management in a Period of Transition'

Tables 19 to 21 give an indication of the changes in the balance of payments and in debt accumulation plus repayments. The deficit worsened over the decade but never exceeded its 1975 level. Borrowing was limited before 1973, but, as the terms of trade (see table 20) worsened in the middle years of the decade and the demand for imported food (among other goods) rose, so short term borrowing from private banks abroad increased. By 1977 these expensive loans were, to some extent, replaced by longer term loans from GODE (see Appendix 2) and the USA. In the last two years of the decade foreign currency earnings from petroleum exports, Suez Canal tolls and tourism grew rapidly as did remittances of Egyptian workers abroad.

These financial inflows enabled consumption and investment to grow at a faster rate than output, particularly in the late 1970s. They also reduced the pressure for domestic reform, by providing an alternative source to domestic savings. There was a kind of circularity to this; the foreign sector was liberalised much more than the domestic economy because it offered easier opportunities for reform. The results of these reforms reduced the pressures to change policies and institutional arrangements in the domestic economy. More funds were available to pay, for example, wage increases unlinked to those in output. This makes evaluation of the liberalisation programme therefore become a complex matter. The improvement in the foreign sector was at least in part the result of government action. It made the problems of the domestic economy less pressing. For the policy makers, in their political capacity, this was a success, but from the viewpoint of the development of the economy different conclusions can be drawn. This matter will be taken up in the concluding chapter.

TABLE 18: DOMESTIC DEMAND AND SUPPLY GAP, INVESTMENT AND  
SAVINGS GAP 1970-1979

174



SOURCE: IFS ; IMF

Chenery and Strout have suggested that developing countries face three constraints, usually consecutively (1). These are shortages of savings, skills and foreign currency. Foreign aid can assist in dealing with all three. It should enable the economy to deal with each shortage successively. In Egypt there is evidence of all three shortages occurring simultaneously but there is little evidence that foreign aid per se made these constraints less binding. Although investment was increasingly financed by foreign aid, so was consumption in the public and private sectors. According to Efrat, grants from Arab States worth nearly \$5bn in the 1970s, went on military spending before 1973. Given the growth of public consumption, this was likely to have persisted in the period after 1973. Funds from Arab countries were not accompanied by technical or other expertise. Only the USA set up a major aid related mission with a range of technical experts. Foreign investment brought outside experts but, in so far as it was concentrated in non-productive sector so the benefits were limited. (see Chapter 7). Aid did permit a large increase in imports. These consisted of investment as well as consumption of goods and the former contributed to an increase in industrial output. Foreign aid enabled investment to be increased and this enabled the economy to expand. High capital output ratios in the areas of highest investment, limited its effect however. These were necessary but not sufficient conditions for growth; in the long run they did little to encourage self sufficiency.

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- (1) H. Chenery & A. Strout 'Foreign Assistance & Economic Development' American Economic Review, September 1966.
  - (2) M. Efrat 'The Defence Burden in Egypt during the Deepening of the Soviet Involvement in 1962-73', PhD Thesis London University, May, 1981, quoted with the Author's permission.

Other aid flows (mainly loans) were increasingly used to repay debt. Between 1970 and 1978 disbursed debt outstanding (medium and long term borrowing) and disbursed banking facilities (short term borrowing) increased by \$8.576m (Table 22). Repayments of principal in the years 1970 to 1977 were \$11.310m and interest payments were \$1.329bn.

The burden of debt is assessed in Tables 24 & 25. It is broken down according to the source of borrowing. Various definitions are given, all moved in the same direction each year. The burden fell between 1970 and 1972 but grew in 1973, except when allowance is made for inter-government grants. By 1977 two indicators showed an increase and two showed a slight fall over 1976. In 1978 three indicators showed an increase and one a fall.

Given the range of definitions available only a general conclusion is possible. The debt burden rose over the period and, when grants are excluded, it exceeded the inflow of foreign currency (excluding further borrowing) considerably.

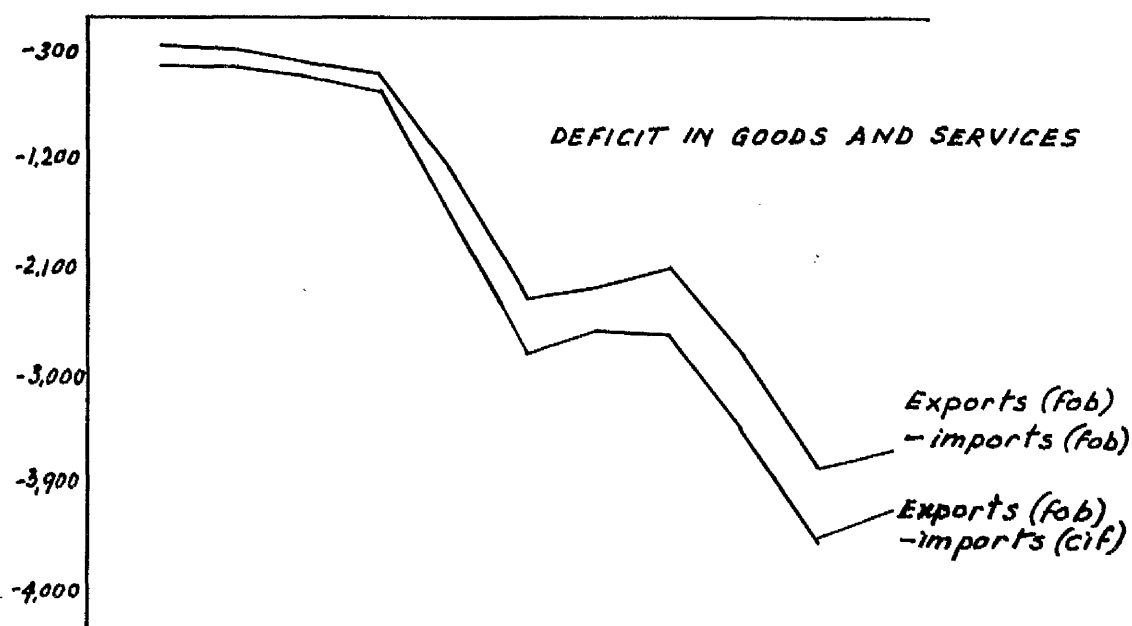
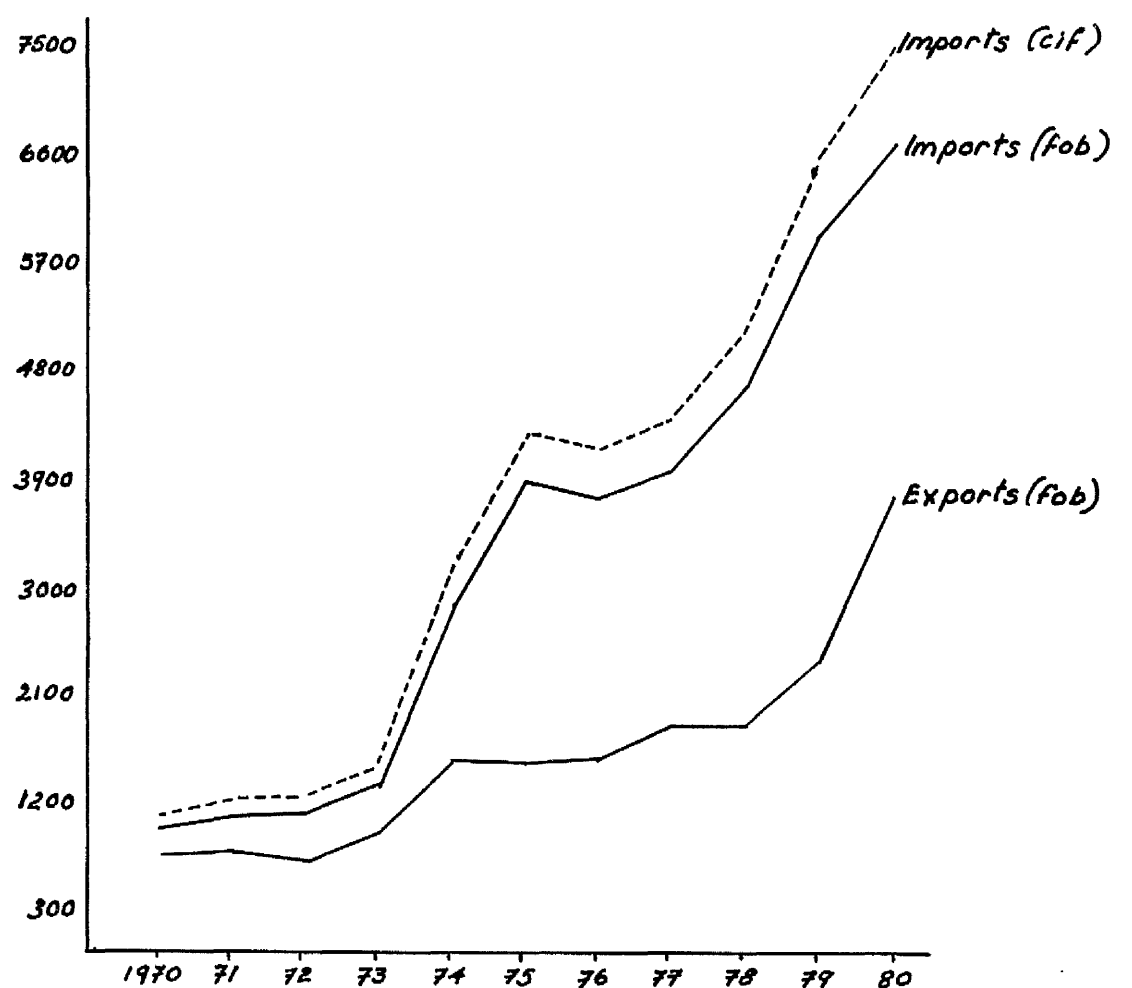
The burden of interest payments was higher in 1978 than in 1970 according to all the definitions given in Table 25.

Table 20: Terms of Trade for Cotton Exports & Wheat Imports 1969-76  
(£E)

	1969-70	1973-4	1974-5	1975-6
1. Wheat (cif/ton)	25	79	112	88
2. Cotton (Menoufi extra long, fob/ton)	530	1200	844	677
3. Ratio of 2. to 1.	21	15	9.5	9.4

Source: K. Ikram, 'Egypt: Economic Management in a Period of Transition'

**TABLE 21: EXPORTS, IMPORTS AND THE DEFICIT IN GOODS AND SERVICES \$ M 1970-1980**



SOURCE: Table 21 below

Table 22: Balance of Payments \$M

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
1. Current A/c Bal.	-150	-207	-170	-78	-324	-1398	-807	-814	-934	-1506	-436
- Export fob	817	851	813	1000	1672	1568	1609	1974	1933	2424	3854
- Imports fob	1084	1131	1170	1429	2914	3942	3842	4038	4743	6003	6813
- Imports cif	1191	1244	1287	1571	3203	4322	4207	4487	5270	6669	7571
Other Private Transfers	4	11	5	6	42	90	87	61	51	56	95
Inter-Govt. Grants	304	268	290	635	993	986	623	386	274	36	1
Remittances	29	27	104	117	268	366	755	928	1773	2213	2954
2. Capital A/c Bal.	164	207	179	-68	344	1432	838	782	951	1496	401
- Direct interest	0	0	0	0	0	9	82	105	318	1216	548
- Drawings on official loans	150	174	183	257	247	801	746	2307	1539	948	1013
-to central bank	0	0	5	40	49	261	59	1224	500	0	0
-to government	0	0	15	5	0	321	75	281	81	1	0
- Trade Credits used	142	210	230	160	273*	363*	500*	415*	605		
- Trade Credits repaid	153	150	186	277	284*	280*	413*	551*	605		
Repayment of Official loans	159	177	109	143	369*	290*	187*	228*	248	248	297
Other Liabilities					2	1317	390	-142	9	-140	-177

/Cont'd.....

Table 22 /Contd....

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Non-official (net)	-10	0	-1	0	-12	82	66	136	-200	109	-103
Drawings on loans	NA	NA	NA	NA	273	363	499	914	386	477	786
Repayment	NA	NA	NA	NA	285	281	413	550	586	556	869
Other Short Term Capital	-	124	225	-113	-24	-125	-38	-36	-41	-28	-56
Of Deposit Money Loans											
- Assets	0	0	-6	-41	-48	-238	-97	-217	-153	-380	-223
- Liabilities			29	24	274	611	-249	-17	-341	279	340
3. Errors & Omissions(1-2)	-10	0	-9	-10	-20	-34	-31	-32	-17	12	35

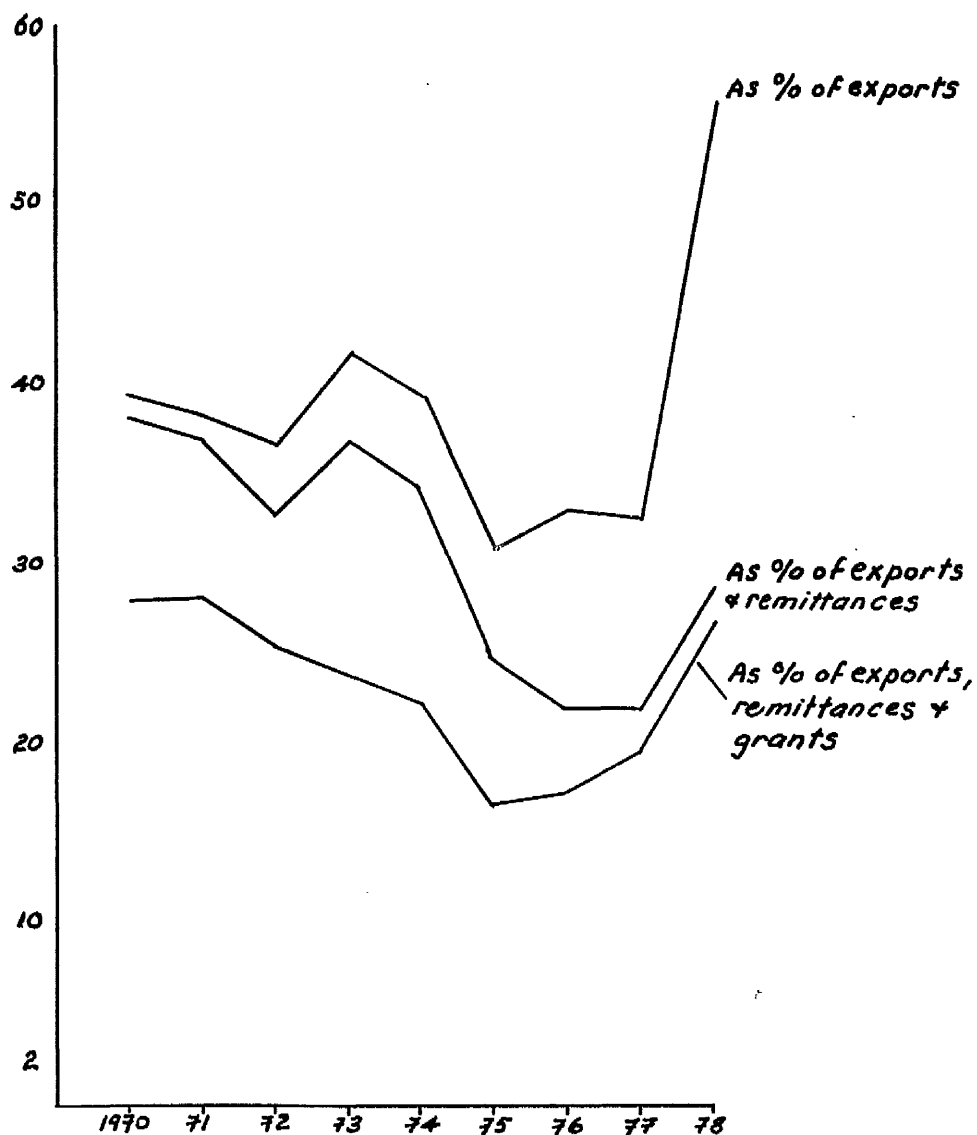
Source: Balance of Payments Statistics Yearbook 1970-73 - Vol.28 Part 1, 1977  
1974-80 - Vol.33 Part 1, 1982.

\* = Ikram op cit P347.

Converted from SDR to \$.



TABLE 23 : REPAYMENTS OF OFFICIAL (GROSS), NON-OFFICIAL (NET)  
DEBT AND TRADE CREDITS (GROSS) 1970-1978



SOURCE: Balance Payments Yearbook U.N.

Table 24: Total Debt & Short Term Borrowing Abroad, 1970-1979 \$bn

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Disbursed Debt Outstanding(1)	1.649	1.802	1.915	2.024	2.834	4.830	5.760	8.093	9.920	1.133
Disbursed Banking Facilities(2)	.148	.133	.141	.497	1.081	1.169	1.396	.556	.443	N.A.
Total	1.787	1.915	2.056	2.521	3.915	5.999	7.156	8.649	10.363	1.133

Sources: (1) 1970-72 World Debt Tables (IBRD) 1978

1973-79 World Debt Tables (IBRD) 1980

(2) K. Ikram op cit P362.

Table 25: External Debt Repayment, 1970-1980 (\$m)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
1. Debt - Interest	38	26	42	57	70	115	111	340	387	236	486
- Principal	247	272	307	513	447	480	554	758	824	804	1024
2. Banking Facilities											
- Interest	14	15	16	24	113	192	81	75	57	NA	NA
- Principal	281	320	342	355	959	1992	1353	2130	954	NA	NA
Total (1 & 2)	580	633	707	949	1589	2779	2099	3303	2202		

Sources: As above

1) Figures for 1980 are IBRD Estimates.

## Conclusions

The government was faced with two main tasks in the 1970s. It had to finance and organise the development of the economy, largely through investment. It also had to maintain the real incomes of the poor mass of the population. The latter had to be done at a time of rising international prices, nearly static domestic food production and with a growing population. The liberalisation of the trade and exchange rate systems exposed the economy to international price movements more than ever before, but the planning system did not foresee these effects until the late 1970s. Even then the lack of coordination and financial planning meant that targets remained unrealistic.

The planners assumed that over time the domestic saving ratio would increase, reducing the need for external finance. The savings ratio did increase in the early 1970s but fell towards the end of the decade. In 1975 domestic savings covered 37.1% of investment. Under the 1978 plan it was supposed to cover 78.8% in 1980 and 100% in the year 2000. There was no discussion as to how the savings ratio would be increased (1). In this sense there was no real financial planning.

Planning of finance was of special importance in Egypt in view of the government's problems in raising revenue. Low receipts from income and capital taxation reflected fundamental political, institutional and administrative weaknesses. The buoyancy of indirect taxation reflected a dangerous reliance on imports of consumer goods which did

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(1) National Bank of Egypt, Economic Bulletin Volxxxix No.1, 1978 P5.

little for the economy and exacerbated social tensions. That the public sector was not a major source of profits for the state was a result of government policy, especially with regard to pricing. Government policy was therefore self-defeating; by holding down public sector prices for short term socio-economic reasons the state added to its deficit. In the conditions which prevailed in Egypt, this meant that inflationary borrowing was required, something which undermined the government's stabilisation and long term growth objectives. Even this was only possible because of the special circumstances which enabled Egypt to import foreign finance and pay her bills with emigrant remittance funds and from the late 1970s with petroleum revenues. These sources of foreign currency, which were not the result of domestic production (in industry or agriculture), are examined in Chapter 7.

The structure behind these policies was that of a partly liberalised economy. The external sector was opened up but the domestic sector was not. The planning framework bore less relation to reality as the foreign sector responded to international pressures and opportunities and the rest remained bureaucratically controlled. The kind of fiscal and monetary imbalances analysed here were therefore direct results of the mix of policies followed.

## Chapter 7: The Foreign Sector

### Introduction

The balance of trade in goods and services moved into ever larger deficit in the 1970s (1). Imports of goods and services played a far greater role in 1980 than in 1970. So did capital imports.

Despite this, most of what occurred in the foreign sector went unplanned, except in the broadest sense. By permitting emigration, encouraging remittances, making the political changes required to reopen the Suez Canal and develop the Eastern Oil Fields, Egypt made great use of her natural and human resources. These yielded very large sums in foreign currency, although emigration had costs which are examined below. Whenever the government eased fiscal and monetary policy, imports rose. The state itself imported many commodities both directly and through its control of the public sector. The lack of planning resulted from the view of the foreign sector as an area of opportunity for liberalising the economy.

In this sector, as elsewhere, incentives for efficiency were lacking. There were a number of very different reasons for this.

The first was that for many commodities, during much of the period under examination, the real exchange rate was overvalued. This encouraged imports and discouraged exports. It therefore discouraged domestic production.

The second reason was the increased availability of foreign exchange from around 1975. There were various sources of this, each of which will be examined below. Spending foreign currency became a panacea for economic problems.

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(1) Table 18, Chapter 6.

A third reason was the institutional arrangements which existed in the economy. Much of the public sector's foreign trade was carried out by publicly owned foreign trade companies. These firms made their profits by maximising the amount of trade which they carried out. With the constraints on exports (which are examined below), their objective was to maximise imports. Imports therefore had a lobby within the public sector.

Finally, the history of foreign exchange shortages in the 1960s and early 1970s meant that when foreign currency became available it was usually spent up to the budget limit. This was one way of ensuring that the budget would be maintained the following year. It was also an easy way of increasing output in the middle of the decade. As a result capital goods as a share of total imports rose from 13.5% in 1974 to 32.6% in 1978 (1).

State control over the foreign sector meant that it had considerable influence over the balance of payments but this element of control was not the same thing as planning. For example, the state brought in consumer goods but it did not monopolise their supply, nor did it decide on an optimum supply. As the foreign sector was liberalised so it was increasingly left to the market to determine supply.

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(1) Table 6

### Plans for the Foreign Sector

As long as plans were issued they said something about foreign trade and payments. The 1980-84 plan will be briefly examined as an example. It called for the acceleration of export oriented sectors and the implementation of import substitution projects. It called for an improvement in the balance of payments as well.

The plan, which was issued in 1979, proposed the implementation of a unified exchange rate as a means of rationalising the foreign sector. This happened in 1979. The long term aim was to have foreign finance cover imports of capital goods and technology only.

The choice of projects in the economy depended to a large part on what foreigners were interested in financing. This was because domestic savings were low and capital imports were needed as noted in Chapter 6. For this reason only 0.3% of disbursed foreign assistance and 3.3% of allocated aid went to agriculture up to the end of June, 1979 according to the data presented in the plan (1).

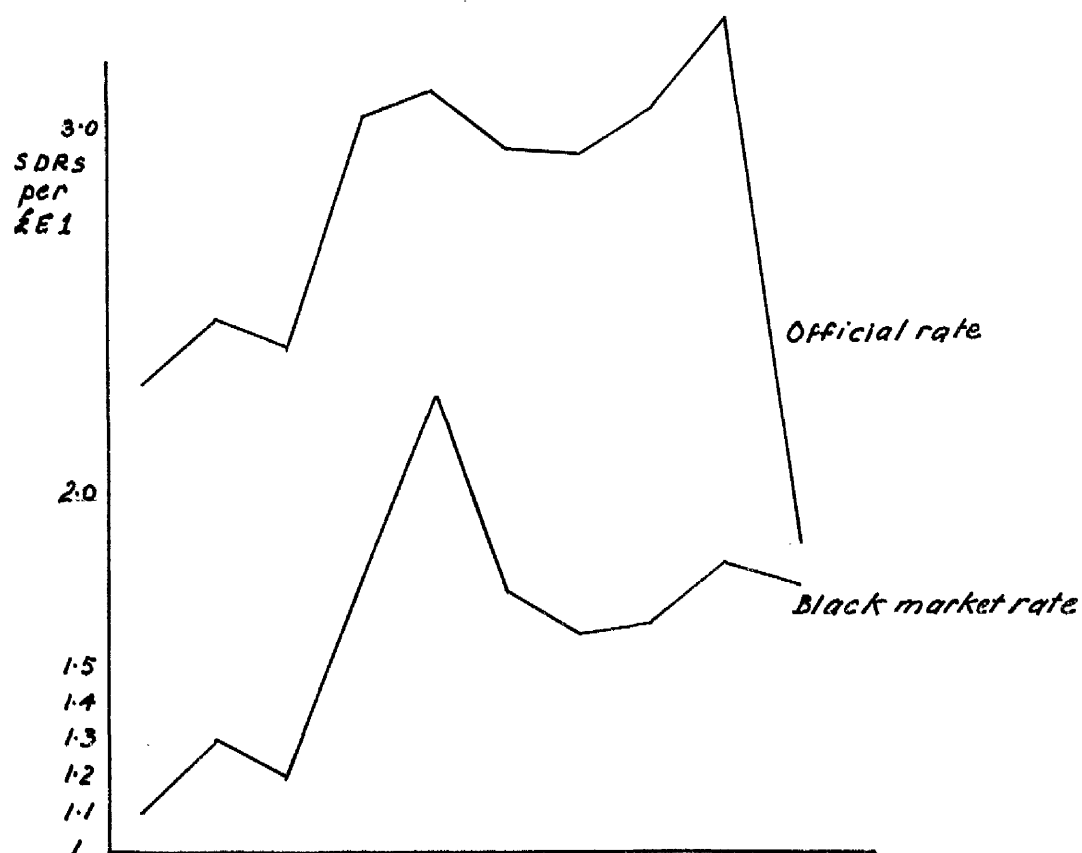
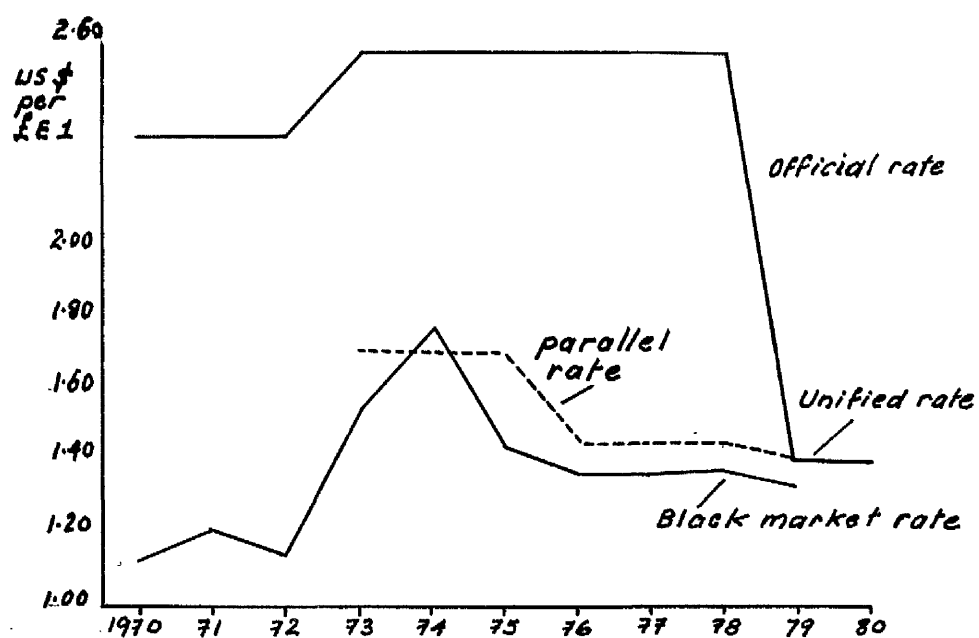
The plan did not suggest how exports were to be increased except through the unification of the exchange rate.

### Trade Policy and the Exchange Rate

Between 1970 and 1974 most imports were funded by the foreign exchange budget controlled by the government. After estimates were made of the foreign exchange earnings of exports of goods and services, foreign credits and debt servicing requirements, a residual was left. This was in convertible and bilateral account currencies and

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(1) A.R.A. Meguid, 'Egypt's Development Strategy and Growth Objectives, 1980-84'

TABLE 1: THE EXCHANGE RATE SYSTEM 1970-1980

SOURCE: INTERNATIONAL FINANCIAL STATISTICS, IMF 1978 & 1983  
PICKS CURRENCY YEARBOOK 1977-9, NEW YORK 1980



was allocated to each sector. Imports were then decided on by Boards and Organisations in charge of each sector. Non-residents could use the premium exchange rate to buy foreign exchange, paying 35% above the official rate. There were tariffs which, according to Girgis, came to 42% nominally on a national average value added weighted basis (1). Writing in 1980, Ranney found a similar pattern and extent of tariff discrimination as Girgis had (2).

By 1974 the parallel (premium) market had grown and so the area of direct government control had become relatively smaller. In 1976 most imports were shifted to the parallel market. This meant that they were subjected to a once for all devaluation of as much as 43%. Between 1976 and 1980 the parallel market exchange rate fell by 3% against the US Dollar (3). Egyptian prices, as measured by the consumer price index, rose by 66% between 1976 and 1980. In reality they rose much more as the official index was heavily weighted with subsidised goods and services. US export prices rose by 43% (4). Against her main trading partner, Egypt lost at least 20% in competitiveness (5). This affected all goods and services in the parallel market in 1976.

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(1) M. Girgis 'Industrialisation and Trade Patterns in Egypt', P115

(2) S. Ranney 'The Open Door and Industrialisation in Egypt: A Preliminary Investigation', op cit

(3) Calculated from International Financial Statistics, IMF 1981 Yearbook.

(4) Calculated from International Financial Statistics op cit

(5) In 1975 65.8% of Egypt's imports came from the USA. In 1980 the share was 72.5%. 'Directions of Trade', 1982 Yearbook, IMF.

Table 2 shows how the inflation rate differential with the USA increased from 1975 and especially after 1979, the period in which the exchange rate system was supposedly being rationalised. This encouraged imports and discouraged exports. It should be noted that the Egyptian inflation rate was considerably higher than the Table shows because the latter was biased towards subsidised items. Table 1, Chapter 5 shows how far this was true for two commodities.

Despite the continued liberalisation, control over imports was retained through the Open Licence system, but this was a much freer regime than its predecessor.

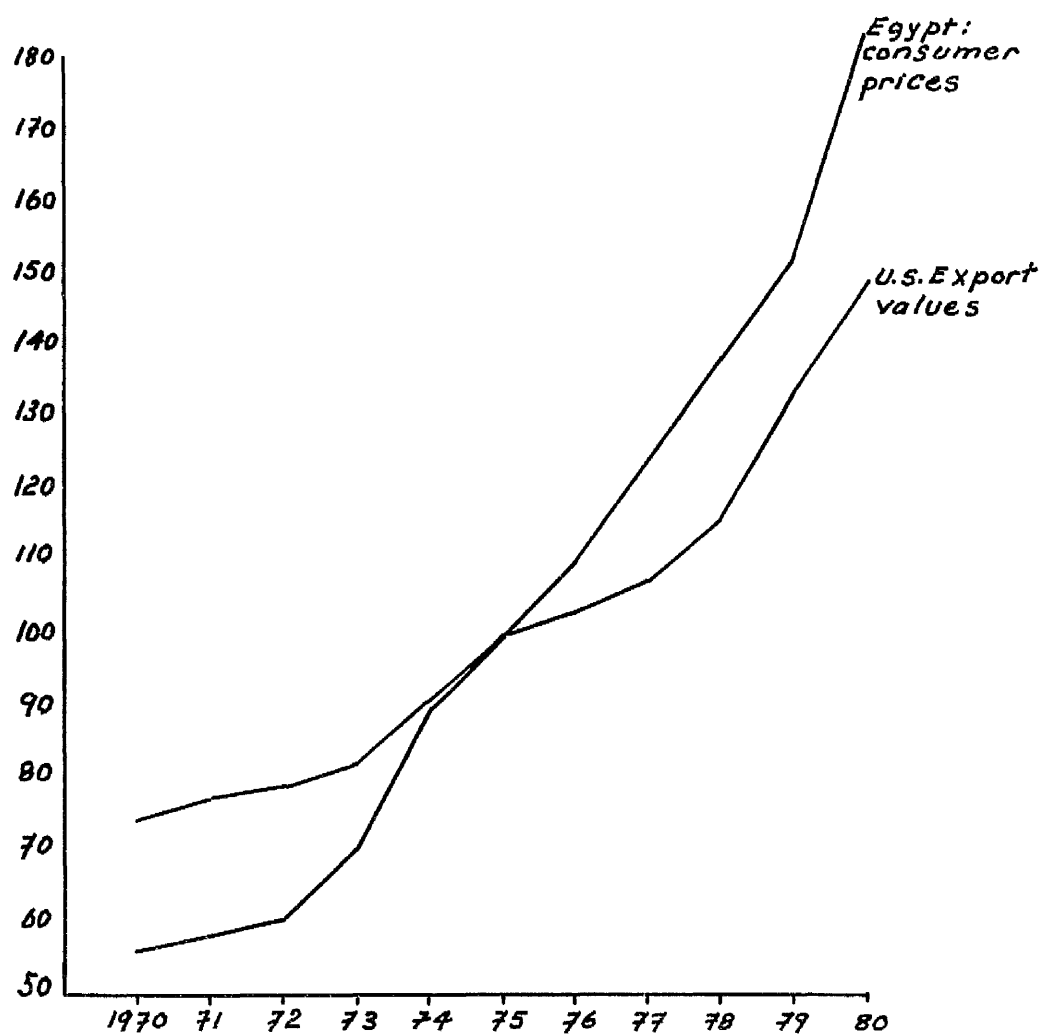
The relative freedom within the parallel market was limited by periodic shortages of foreign exchange. In the free market foreign exchange was worth considerably more and so funds were diverted from the parallel market. This limited legal imports but permitted illegal ones because the free market was in effect a black market. The government's policy was to shift imports from the foreign exchange budget to the parallel one.

In order to see how far liberalisation of the trade system has gone it is useful to refer to the periodisation suggested by Krueger (1).

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(1) A.O. Krueger 'Liberalisation Attempts & Consequences', National Bureau of Economic Research, Ballinger 1978, P302-303.

TABLE 2: INDICES OF EGYPTIAN CONSUMER PRICES AND U.S. EXPORT VALUES 1970-1980 (1975 = 100)



SOURCE: IFS, 1981 Yearbook, IMF.

Phases in the Evolution of Exchange Control Regimes

- 1) Quantitative restrictions ((QRs) imposed and intensified on international transactions.
- 2) Various price measures taken to offset undesired effects of restrictions.
- 3) Systematisation of phase 2 changes: formal exchange rate changes and removal of some phase 2 surcharges. Reduced reliance on QRs.
- 4) Continuation of liberalisation trend
- 5) Full liberalisation

The movement from early to later phases entails, according to Krueger, four closely related processes. Firstly there is a rationalisation of the system when piecemeal measures, dominant in Phases 1 and 2 are replaced by an across-the-board exchange rate change. Secondly, the reduction in premiums and/or the replacement of QRs by price measures liberalises the system. (The term 'Liberalisation' has been used more broadly so far, to include all moves towards reliance on market forces). Thirdly, there is a reduction in the bias of the price system due to the increased domestic price of exportables relative to imported goods and import substitutes which result. Finally, there is a reduction in the

variance of effective protection rates. This is because the move from QRs to pricing measures usually reduces the amount of protection and raises the domestic prices of those items previously negatively protected (1).

In 1975 import duties (most of which were customs duties) were equal to 32.6% of the value of imports. In 1979 they were 33.2% (2). It is not possible to estimate the value of imports coming into the country illegally nor the increase in this activity, but the evidence is of a rapid expansion which partially invalidates the comparisons made.

In terms of Krueger's categories of the phase of liberalisation Egypt in the 1970s moved from Phase 3 to Phase 4. This suggests that while movement through the phases has not been rapid, the end situation is favourable from a liberalisation point of view.

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(1) A.O. Krueger, Ibid P15-16.

(2) Calculated from 'Goverment Statistics Yearbook' Vo.V, IMF, International Financial Statistics' IMF and Table 10, Chapter 6. Conversion at Official Exchange Rate.

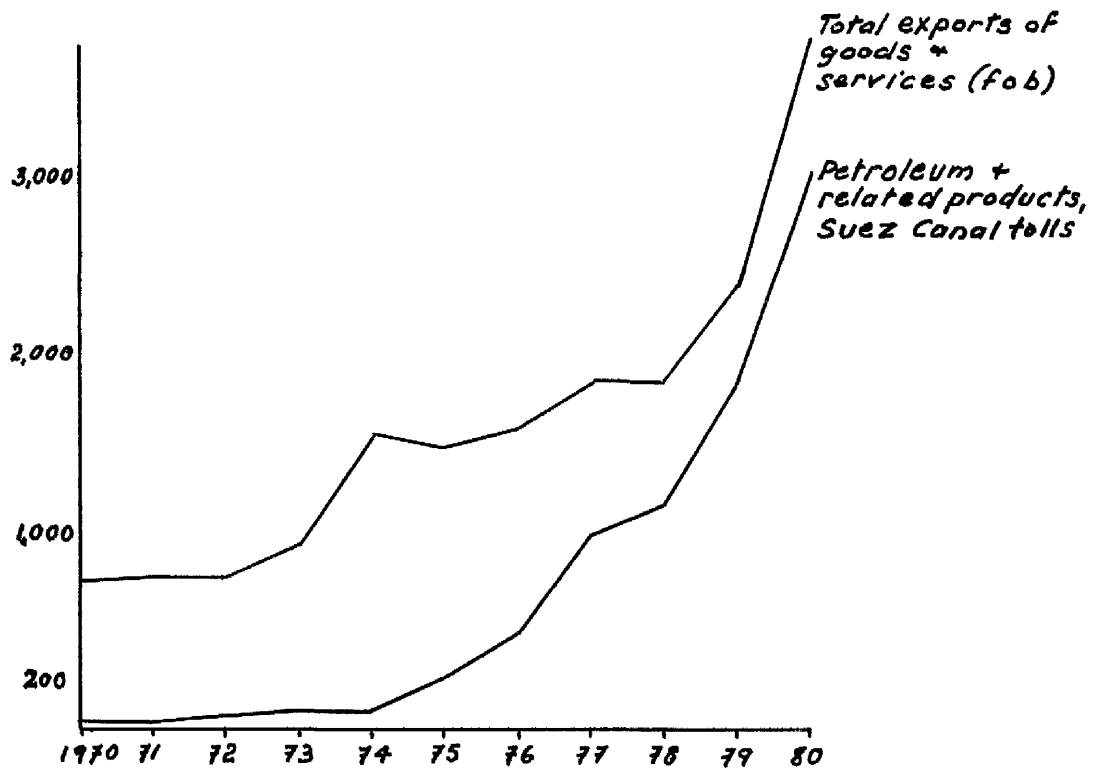
## Exports

Export Revenues from the rental sector were the main source of export growth in the 1970s. Oil exports depended on foreign demand and internationally determined prices. Suez Canal tolls depended on international demand for use of the Canal. Remittances depended on foreign demand for Egyptian labour. None relied on manufacturing in Egypt. All increased without changes in agriculture or industry. Only remittances were related to domestic changes through reforms of the exchange rate system which, to some extent, encouraged emigrants to send funds home.

The liberalisation programme encouraged remittances, and moves towards a military and political settlement with Israel enabled Egypt to reopen the Suez Canal in 1975 and increase her oil export after that date. In this respect, policy was extremely effective in increasing foreign currency earnings.

Tables 3 & 4 show how fast these factors grew and how important they became relative to traditional industrial and agricultural exports.

**TABLE 3: TOTAL EXPORTS AND THOSE OF THE RENTAL**  
**SECTORS 1970-1980 \$m**



**SOURCE: Table 4 below**

Table 4: Rental Items and Total Export (\$M)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
a) Petrol & Products	36	7	54	113	104	164	268	600	688	1347	2500(1)
b) Suez Canal Tolls	0	0	0	0	0	85	311	427	514	589	664
c) Remittances	29	27	104	117	268	366	755	928	1773	2213	2954
d) Totals (a-c)	65	34	158	230	372	615	1334	1955	2975	4149	6118
e) (a+b) as % Exports (2)	4.4	0.8	6.6	11.1	6.2	15.9	36.0	52.0	62.2	79.9	82.1
f) Exports minus petrol and products	781	844	759	887	1568	1404	1341	1374	1245	1077	1354

Sources: a) 1970-73 - Yearbook of Trade Statistics, 1974 & 1975, UN.

1974-80 - 'Recent Development in the Egyptian Economy' ESU Ministry of Economy, January 1981.

b) International Financial Statistics, December 1982, IMF.

c) Table 3 above.

(1) 1980 Estimated by Ministry of Economy, op cit.

(2) Goods and Services, fob; source - Chapter 6, Table 22.



Exports other than oil, measured in dollars were over 25% lower in 1979 than in 1974. As the 1979 figure was affected by a devaluation of the Egyptian pound (via the unification of the exchange rate at the lower parallel market rate) the dollar amount is biased downwards. The 1978 figure, unaffected by this, was 17% lower than that for 1974. Their share in GDP rose by only 3.4% even with oil included. (Chapter 1 Table 1).

This weakness was the result of a number of factors. Mabro explained slow export growth in the 1950s and 1960s as a result of rigidities in the economic structure and policy outlook (1). Girgis concluded that internal conditions, including policy choices, were the main cause of export weakness rather than international conditions of demand (2).

There are two aspects to this bias against exports. Firstly, the system of protection, pricing policy and conditions of demand within the economy militated against exports. Secondly the government was unwilling to adopt a positive policy towards exports, seeing them as a residual rather than as a central variable in the growth process (3).

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- (1) R. Mabro 'The Egyptian Economy 1952-1972' Clarendon Press, Oxford 1974, P181.
  - (2) M. Girgis 'Industrialisation and Trade Patterns in Egypt' J.L.B. Mohr Tubingen 1977, P203-4.
  - (3) Arthur D. Little Inc. 'An Assessment of Egypt's Industrial Sector' January 1978, P97.

Apart from industrial subsidies, which were not specific to exporters, devaluation was the only measure applied to exports. Operating as disincentives to export were the strength of domestic demand which outran the supply of many commodities and inflation.

The foreign exchange shortage in Egypt was dealt with by tariffs and a more rapid movement of imports of goods (but not services) to the parallel exchange rate up to 1977.

The availability of commodities for export depended, to some extent, on the pricing system. Compulsory deliveries of cotton to the government at prices lower than those on world markets, meant that producers lacked an incentive to increase output. They may furthermore, have been producing the wrong crop or product compared to that which would have been developed in a free market. Specifying which crop is to be produced may be sub-optimal but then paying less than the international price for it compounds the problem. "Price differences" plus the price paid to the farmer for, say, cotton equal the export price and are a measure of the disincentive to the private producer. In terms of personal incentives this was less important for public sector industry because the choice of what was produced did not directly affect the incomes of the producer. An example of the former was the price paid to farmers for cotton. In 1976 this was £E32/Kantar while the export price was £E46 per Kantar. The total purchased from farms was £E100m and the total value of export, £E155m (1).

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(1) R.S. Eckhaus, F.D. McCarthy & A. Mohie Eldin 'Multisector General Equilibrium Model for Egypt', Cairo University Development Research and Technological Planning Centre. Updated version of 30 June 1978 Report. (Updated Version undated).

## Imports

An important feature of Egyptian economic policy making in the late 1960s and early 1970s was the use of imports to deal with short term economic and political problems.

In 1970 when President Nasser died, the supply of imported and locally assembled luxury goods was sharply increased. This also occurred after the 1967 war, when the regime faced severe domestic tensions which resulted in riots early in 1968. Local output of such items as automobiles and televisions could be increased rapidly by importing more kits, or parts, used in the assembly of the final product. It was not always necessary to invest in capital equipment in order to increase production. Years of relatively high domestic production were those of high capacity utilisation. Higher levels of production or assembly did result in high imports. The policy of importing more luxury goods and kits for local assembly could not be sustained for more than a few years at a time before 1975 because of the weakness of the balance of payments and consequent foreign exchange shortages. This is illustrated in Table 5 below.

Table 5: Imports & Domestic Production of Cars and Televisions 1965/74

	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>
<u>Cars</u>										
-Imported	2158	1811	1023	3545	3944	9489	15196	3998	7448)	
-Domestic										)25800
assembly		552	494	1891	2325	3590	5750	5380	5591)	
<u>Television</u>										
-Imported	21*	328*	36*	84*	249*	13867	23309	18352	18745)	
-Domestic										)87900
assembly	56200	50400	48600	29900	43200	64200	66900	75600	49100)	

Source: Federation of Egyptian Industries Yearbook, various editions (1967-73) and K. Ikram op cit P88, T4-3 (1974)

\* = tons

The import boom which followed Nasser's death and continued during the early period of Sadat's rule ended in 1972. By then the threat of international opposition to the new President had receded and the government took steps to restrict the inflow of luxuries. This was done according to the Prime Minister because of the need to transform the economy into a 'war economy' (1). Imported luxury goods, many of which came into the country illegally, did not provide the right background against which to ask for sacrifice from the population. A ban on many such imports was announced in 1972 along with a 50% increase in customs duties on others.

In 1973 the number of cars imported rose by 86%. There was no fall in domestic production to be made up for. This occurred despite a continued severe foreign exchange shortage. Neither during the war, nor in the period immediately after it, was there any reduction in imports comparable to that which occurred in 1967. Indeed, taking imports and domestic production together, demand for cars in 1974 was 98% higher than in 1973. As the foreign exchange constraint eased in the late 1970s, so imports were permitted on an even more liberal basis. Yet the years between 1973 and 1977 saw a rapid worsening of the balance of payments as the cost of many basic, non-luxury, imports rose and Egyptian demand for them expanded. By 1977 the debt servicing crisis had reached its peak but imports of cars and televisions continued to increase rapidly in value terms.

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(1) Statement to the People's Assembly 23 January 1972 reported by Radio Cairo, quoted in 'Record of the Arab World' Beirut 1972, Vol. 11, P.1281.

In May 1980 President Sadat ordered reductions in import duties, among other measures designed to slow the rate of inflation. The reduction applied not only to basic foodstuffs and raw materials imported but also to household and consumer durables, including luxury items such as colour televisions (1). The goods which flowed into the country in greater quantities as a result, included some items which competed with domestic production. By 1980 the foreign exchange constraint was no longer a major problem for policymakers; it had all but disappeared. Other considerations came to the fore, such as the social impact of increased luxury goods imports in a country with much poverty. By lowering the price of luxury goods the President hoped to lower the cost of consumption for those who could afford such goods at the old price and to make them available to a slightly wider section of the population. This may not have been a carefully calculated move, but the effect was of the kind described.

Smuggling was a significant issue in Egypt and should be considered alongside declared imports. Although it is likely to have declined as import controls eased, significant volumes of goods were thought to have been smuggled into the country in the early 1970s. In February 1972, the Deputy Prime Minister for Economy and Foreign Trade stated that over the previous four years £E80m worth of commodities and 33,000 cars were known to have entered the country illegally (2). If each car is conservatively valued at £E2500, then their total value was to £E82.5m.

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(1) The Economist 24.5.1980.

(2) Al Ahram, Cairo, 19 & 21 March, 1973. Quoted by N. Ayubi, op cit P383.

The total value of smuggled goods is much higher in any period than the government states. A more recent example of the magnitude of the problem was cited in an official report issued in 1979 (1). In it, the Ministry of Economy criticised arrangements at the Port Said Free Zone. All imports into Port Said were, in 1979, exempt from customs duties, but the city was not sealed off from its surroundings. It had both legal and illegal entry and exit points. At one such point in 1979, 40,000 visitors a day were going into the city and smuggling out goods.

The Economic Studies Unit at the Ministry of Economy therefore recommended that customs exemptions be limited to capital goods only (2).

Weak administrative control was evident in the foreign exchange system. Since 1974 the freedom to use foreign exchange has been substantially increased. Traders and individuals who held foreign currency generated by transactions which fell under the parallel market were allowed to use those funds for direct importing of goods and services. This amounted to implicit approval of a free market for imports. In 1975 the number of goods which could be imported under this 'own exchange' system was dramatically expanded.

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(1) Ministry of Economy, Economic Studies Unit 'Study of Law 43 Investment Policies', December 1979 P36.

(2) Ministry of Economy, E.S.U. op cit.

### The Composition of Imports

The figures in Table 6 do not fully reflect the share of consumer goods in total imports. This is because many such imports were excluded from exchange control data. Smuggled goods (via Port Said and elsewhere) were also excluded, by definition, from customs data. The Central Bank do not specify which source they use, but as both series are deficient they should be used with caution in assessing the level of consumer goods and luxury imports.

In addition it should be noted that the category of intermediate goods included such items as kits for the assembly of cars, televisions and other consumer durables.

Fuel as a share fell as local oil production increased. Intermediate goods fell possibly because taxes on some such goods were higher than on final products. Capital goods increased their share as investment increased and the import content of investment remained high. Even without the qualifications given above, the share of consumer goods rose.

Table 6: Shares in the Import Bill, 1970-1980 (%)

	Fuels	Raw Materials	Intermediate Goods	Capital Goods	Consumer Goods
1970	8.2	13.5	37.6	23.4	17.3
1971	7.0	20.1	37.4	20.4	15.1
1972	5.4	17.0	43.4	19.9	14.3
1973	2.0	22.3	36.5	21.9	17.3
1974	2.6	32.0	34.3	13.5	17.6
1975	6.8	18.8	40.2	16.9	17.3
1976	3.9	16.2	29.8	27.1	22.9
1977	1.8	13.4	32.8	30.1	21.9
1978	1.1	11.6	30.9	32.6	23.8
1979	0.6	12.2	33.3	30.6	23.3
1980	0.7	13.9	37.5	24.5	23.4

Sources: 1970-78: Economic Review, Vol.xix, Central Bank of Egypt  
Nos. 3 & 4, 1979.

1979-80: Economic Bulletin, Vol.xxxv, National Bank of  
Egypt, No.2, 1982.



Imports were financed by remittances, but the latter increasingly took the form of goods rather than cash. These imports, paid for by Egyptians abroad, were not included in the balance of payments figures given in Table 22 of Chapter 6. Those figures are based on exchange control records and goods imported by emigrants did not require currency exchange. They were included in data on customs clearance but this data excluded many exempted items and imports by the government. There is therefore no satisfactory series on imports. The share of remittances coming into Egypt as goods rose from 12.1% in 1974 to 62.1% in 1978 and 59.4% in 1979/80 (1).

This shows evidence of the financial repression discussed in the last chapter. At its simplest, despite the adoption of a more favourable exchange rate, there were increased incentives to buy goods rather than save in banks, at least until 1978. From then on, as has been shown, interest rates, especially on foreign currency account, rose. This may have been the cause of the increase in the share of cash in remittances from 1978 to 1980 as well as in the total volume of remittances and the proportion held in foreign currency.

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(1) 1974 and 1978 from National Bank of Egypt, Economic Bulletin, Nos. 3 & 4. 1979 T8.

1979/80 from Central Bank of Egypt Annual Report 1980/81 Sept. 1981.

The National Bank of Egypt has stated that 31% of 'own exchange' (i.e. remittance financed) imports in 1976 and 23% in 1978 were 'luxury or unnecessary' (1). This definition excluded 'means of transport'. If they are assumed to be mainly cars, which is reasonable, then the share of luxury goods rises to 58% in 1978. Additionally, foodstuffs amounted to 14.8% in that year. These are unlikely to have been basic goods and therefore can be added to the total for luxuries.

All of these figures excluded imports via Port Said and its free zone. These came to \$70m in 1976, \$196m in 1977 and \$233m in 1978 (2). According to the Ministry of Economy, only about \$60m of the three year total (12%) was subject to tariffs, consumer goods constituted 80% of the total and between 33% and 75% of the value of imports into the zone was then smuggled into Egypt (3).

The liberalisation encouraged demand for imports by increasing their availability. They met the gap between savings and investment, the lack of domestic food production and the overall imbalance between demand and supply in the economy. Financial repression provided speculative incentives to import as well.

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(1) N.B.E. op cit P167-168

(2) Ministry of Economy, Economic Studies Unit 'Study on Law 43 Investment Policies' December 1979, P36.

(3) Ibid.

### The Reorientation of Egypt's External Trade

In 1970 49% of Egypt's imports and 74% of her exports were with countries which had bilateral trade or payments agreements with Egypt (1). These arrangements had existed since the 1940s with West European countries and provided for tight government control over trade so as to avoid the build up of deficits in countries short of foreign exchange. Western nations ceased to use such arrangements in the 1950s as their financial position improved but the Soviet block continued to trade under these arrangements. In the 1960s as Egypt moved closer, both politically and economically to the USSR, so bilateral trading arrangements were worked out with Soviet block countries. They also existed between Egypt and a number of developing countries.

Throughout the period of bilateral trading, Egypt's exports went mainly to the centrally planned economies and others with agreements whereas her imports came mainly from free market economies. The effects of this trading system have been analysed by Girgis (2) and Hansen and Nashashibi (3). From a policy point of view, they had important implications. Those who sought to liberalise the economy in the period after 1968 saw freer foreign trade as a central objective. Whatever the precise effects of the controlled system were, compared with a freer one they felt that it was not beneficial (4). Change

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(1) M. Girgis 'Industrialisation and Trade Patterns in Egypt' J.C.B. Mohr Tubingen, 1977, P159.

(2) M. Girgis op cit.

(3) B. Hansen & K. Nashashibi 'Egypt: Foreign Trade Regimes and Economic Development' National Bureau of Economic Research, 1975.

(4) View of Dr. A.A. Hegazi, Finance Minister in the late 1960s and early 1970s, interviewed.

was not easy to effect however. In 1974, 30 bilateral agreements remained in force, 12 with Soviet block countries.

A fall of bilateralism meant a decline in the relative importance of trade with the Soviet block. Cotton was one of Egypt's main exports and was totally controlled by the State. Falls in export demand, as a result of the reorientation of trade, meant that production was hit; exporters could not easily move towards more competitive markets with products which had previously been protected by government controls (1).

From 1968 the liberalisers began to reform the bilateral trade arrangements then prevailing. From 1970 President Sadat added political reasons for a move towards changing the trade system. He was dissatisfied with the lack of military aid to Egypt and with the fact that the USSR was unable or unwilling to act decisively on Egypt's side in the struggle with Israel. Soviet involvement in the country was resented and in July 1972 about 15,000 advisors were expelled (2). This was despite considerable economic and military assistance made available by the USSR from the early 1960s and earlier.

The relationship between the USSR and Egypt had two elements each of which needs considering.

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(1) S. Ranney 'The Open Door Policy & Industrialisation in Egypt: A Preliminary Investigation' Center for Research on Economic Development. The University of Michigan, Discussion Paper No.87 August 1980.

(2) M.A. Sadat ;'In Search of Identity' Collins, 1978 P228-231.

Firstly, the trading relationship, under the framework described, showed a total Egyptian deficit from 1962 until 1973 of \$112m. This was a relatively small amount by any standards over such a long period. Efrat has suggested that Egypt received more from the USSR for her exports than she would have done on World markets.

The gain over the period 1962-73 came to about £250m. Egypt exported manufactured goods which would not sell on international markets. That the USSR and her East European allies took these goods meant industrial growth occurred in Egypt which would not necessarily have happened under freer trading conditions (1).

The second aspect was economic aid. From 1963 to 1965 the U.S.A. provided more aid than the USSR and in 1970 and 1971 repayments to the USSR exceeded drawings. Economic aid after 1969 was dwarfed by the amount of military aid however. Although its purposes was military, one of its consequences was economic. It had to be paid off with interest, at least in theory. This in turn had political implications for a country in dangerous financial circumstances.

The decline of bilateralism was an important move towards freer trade. One result of the reduction in state control was a general increase in imports, particularly of consumer goods.

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(1) M. Efrat 'The Defence Burden in Egypt During the Deepening of the Soviet Involvement in 1962-73' PhD Thesis, London University, May 1981. P24-30. (Quoted with permission of the Author).

### Foreign Investment

A central feature of the liberalisation programme was the opening of the economy to foreign influence in terms of trade and investment. The move towards encouraging foreign investment with tax and other incentives was politically, as well as economically, significant because it represented an opening up of Egyptian society to foreigners and a move away from state control of economic activity. If foreigners were to visit the country, sell and invest there, then conditions had to be very different from those which prevailed in the 1960s. Foreigners would not invest in a country which had no private, domestic sector, given Egypt's history. In turn, further local investment would be encouraged by the commitment which the government made to foreign investors. The memory of nationalisations, sequestrations and even imprisonments did not die with President Nasser; his successor had to prove his commitment to the private sector.

The central piece of legislation designed to attract foreign investment was Law 43 of 1974. It was significantly amended in 1977 when, amongst other things, local investors were granted the same privileges as foreigners.

The regime's perceptions of the issues involved in foreign investment is of relevance here and an attempt will be made to compare some of the expectations with the results.

The public sector was involved in a number of joint ventures under Law 43 (known henceforth as Law 43 companies). It also supplied a large share of the capital for investment in certain sectors. This raised sensitive issues about the role of the public sector and the influence of joint venture companies.

The most important issue in assessing the success of a policy is the size of its contribution to economic development. The official view has been implicitly stated to be 'disappointing' and this was one reason for the move in the late 1970s towards a concept of 'Popular Development' which would encourage domestic private sector activity.

Table 7 shows that there was some success in attracting foreign investment. In fact the results have been much more modest if the petroleum sector is excluded. It is the pattern of investment rather than the total amount which has disappointed many Egyptians.

To a certain extent, the investment pattern under Law 43 has been outside the government's control. It vetted all applications and could reject undesirable proposals, but seldom did. It usually approved proposals because it wanted to maximise activity and did not want to interfere excessively. Looking back on the first five years of the policy, some have seen that the government needed to impose a framework on investment under Law 43. This could have been done by rejecting investment proposals which were thought to be undesirable (1).

The policy, at its inception, laid emphasis on storage of goods as an activity to be encouraged. The government pushed for the construction of warehouses in the Suez Canal Zone so that Egypt would develop as an entrepot centre, transshipping goods between Europe, America and the Gulf States. She would be able to make use of the goods stored as collateral on which to borrow and the presence of those goods in the country might in turn encourage investment by highlighting the fact that it was peaceful (in contrast to the

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(1) Dr. A.A. Hegazi, former Deputy Prime Minister responsible for the introduction of Law 43, interviewed.

position before 1974) (1). After the 1973 war the government came under considerable pressure from the Suez Canal Zone to speedily reconstruct the area which had most directly suffered from war since 1967. It was not therefore disposed to be fussy about the activities which were to go there.

This aspect of the policy has, in retrospect, been highly criticised although those who wrote Law 43 deny that it was their intention to permit or encourage any of the abuses which have occurred since 1974. It is one of the clearest examples of a kind of rent-seeking . Warehousing would permit Egypt to sell 'space' and earn an income while producing nothing. She was trying to take advantage of her geographical location.

The nature of the foreign investment which Egypt attracted in the 1970s was closely related to the stage and structure of its development. This was even more true of the domestic private investment which has developed in the 1970s. Egypt had, in the years before 1970, been a closed economy and to some extent it was a closed society. Despite the extensive socialism which had been introduced in the 1960s, there had been an accumulation of private wealth in these years. The possibilities for private consumption were limited as imports were tightly controlled and because the pattern of production inside the economy moved only gradually towards meeting the demand of the relatively well off. As soon as the barriers to consumption were eased, incentives to import or produce luxury items increased. In a country with a recent history of nationalisation and sequestration,

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(1) 'Middle East Economic Digest', 14.1.1977, P4.



there were disincentives real or perceived to domestic production and so imports tended to fill a vacuum. This had a significant impact on the pattern of investment financed by foreign and domestic sources. The pattern was not unique to Egypt: many developing countries began their development processes with production patterns not necessarily suited to the domestic mass market. The mass market in Egypt was supposed to be catered for by the public sector. Entrepreneurs in developing countries are often unsure of the stability of the economic and political structures which exist in their societies and therefore tend to invest in those sectors which will yield quick returns or which involve limited funds. Only when they feel more secure do they become more willing to take risks.

From the international perspective most foreign investment in the 1970s was done by large companies; only they had the resources, knowledge, expertise and even bargaining power to carry it out. Such firms in the manufacturing sector however have tended to concentrate their production in developed economies. Those which have shown the greatest interest in Egypt have been banks, companies in the service sector plus those using locally available natural resources such as petroleum. The latter had access to Egypt in the 1960s.

Table 7: Foreign Investment as a Share of Total Fixed Investment  
1971/2-1978 (£EM).

	1971/2	1972	1973	1974	1975	1976	1977	1978
1. Gross Fixed investment	365.0	378.3	462.4	640.0	1228.0	1323.0	1805.0	2183.0
of which								
-Private	40.0	41.0	38.0	27.5	176.5	236.0	366.0	360.0
-Public	325.0	337.3	424.4	612.5	1051.0	1089.0	1439.0	1823.0
2. Foreign investment	n.a	n.a	n.a	27.0	58.0	117.0	170.0	172
As % of gross fixed investment	n.a	n.a	n.a	4.2	6.7	8.8	9.4	7.9

Source: 1. K. Ikram 'Egypt: Economic Management in a period of Transition' op cit P405

2. K. Ikram Ibid P347.

Figures in source are in dollars converted to £E at the official exchange rate.

Soft drink manufacturers took an interest in the Egyptian market both because of its size and because of the potential use of local citrus products. These companies were criticised inside the country for making products which were not essential and were even considered socially undesirable in that they represented a pattern of consumption closely related to Western standards. Finally, the room for value added is limited as is export potential.

The amount of foreign investment has disappointed many and the volume of employment created has been limited. Table 8 shows that by the end of 1979, 132 projects were in operation in the manufacturing sector under the provisions of Law 43. They accounted for 29% of the total number of projects in operation and 43% of the total approvals for the manufacturing sector. Manufacturing approval (a guide to the number of applications for that sector) by the end of 1979 accounted for 28 % of total approvals.

Table 8: Investment Under Law 43: Number of Projects at Year's End  
1977/1980

	1977	1978	1979	1980
<u>1. Approved projects</u>	744	903	1079	1287
a) Inland	482	391	766	
b) Public Free Zone	201	295	249	
c) Private Free Zone	61	67	64	
of which in manufacturing	228	243	394	
<u>2. of which: in production</u>	184	334	455	807
a) Inland	112	141	280	
b) Public Free Zone	53	104	137	
c) Private Free Zone	19	39	83	
of which in manufacturing	64	83	132	
<u>3. of which: under</u>				
<u>implementation</u>	227	349	329	
a) Inland	171	259	273	
b) Public Free Zone	44	79	45	
c) Private Free Zone	12	11	11	
of which in manufacturing	96	100	99	

Sources: Study on Law 43 Investment Policies 'Ministry of Economy'  
Economic Studies Unit, December 1979.

Investment & Free Zone Authority 'Facts & Figures' No.IV  
December 1978 and No.VI December 1979.

Egyptian Gazette 17.3.81 quoting the 'Annual Report of the  
Investment & Free Zone Authority'

By 31st December 1978 20,309 people were employed in non-financial Law 43 projects. 9,525 were in the manufacturing sector. The amount of investment in 1979, measured in terms of paid up capital plus loans, per employee was £E16,000 for the whole Law 43 category excluding the financial sector. For the manufacturing sector of the Law 43 group per capita investment was £E9,9000 (1).

These figures were much higher than the average for the relevant sectors of the economy as a whole and this raises the question of how beneficial such a concentration of investment was. In a country with abundant supplies of labour it would seem wise to spread capital more thinly over the whole economy so that its marginal return would be higher. Another possibility would be to encourage the use of second hand or older machinery which might be more labour intensive. This might yield gains in terms of training, education in maintenance experience (the more advanced an item of machinery is the more likely it is to need expert maintenance from the country of its manufacture unless it has been deliberately 'designed down' for use in a developing economy). Simpler equipment might be more comprehensible to the technical cadre available in Egypt.

Another point of view is that the most modern equipment is more relevant to the international companies which Egypt wants to attract. By encouraging them and their choice of technology Egypt is encouraging both profit maximisation inside the firms and therefore gains to the economy.

These are the theoretical questions posed by such a pattern. The economic decision maker faces a somewhat different set of issues and it is these which will determine his response. They include such

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(1) MEED, 14.1.1977, P4, op cit.

questions as whether foreign companies would invest in Egypt if their choice of technology is controlled by the government in order to achieve certain employment targets. Are such restrictions compatible with a move towards a more liberal economy and, if they are, will they be seen to be? They will also be concerned with the question of whether investment is replaceable: if one type of investment is blocked because of its social rate of return is low, will another with higher social returns come on stream.

The last issue is one of the most important from the government's point of view. On the basis of press reports, official studies and statements by potential investors further government interference would probably block investment rather than shift its technological composition or output pattern.

Weak administration has been one of the more serious problems facing Egypt and more detailed intervention might have been beyond the competence of officials. The bureaucracy has, in part, seen the growth of foreign investment and the private sector as a threat. The public sector has seen it as a source of competition with unfair advantages. Private investment represents a kind of decentralisation to those officials who held responsible positions in the planned economy of the early 1960s. Foreign investors faced not only unwilling officials but also a large bureaucracy lacking clear lines of authority between departments and organisations. They had to deal with not only the Investment Authority at the Ministry of Economy, but also with the General Organisation of Industrialisation at the Ministry of Industry. The latter bodies were closely associated with the running of the public sector and to a certain extent represented its interests.

In so far as officials were uncooperative, opportunities were created for a group of intermediaries. This group, consisting in part of former civil servants and public sector officials, sold to the foreign investor its knowledge of the system. The inability of the foreign investor to deal with Egypt's bureaucracy therefore gave rise to rent-seeking, with knowledge and contacts being the items in short supply. The apparent or initial non-cooperation of officials is in this light self-serving. Not only were they trying to protect their jobs in an overmanned bureaucracy, but also they were creating opportunities for bribes, commissions and favours.

The dominance of the public sector meant that many joint ventures were set up between it and foreign investors. This increased the area of interaction between state run bureaucratic organisation and those with the funds to pay rents.

Figures for private and foreign sector investment were biased upwards because foreign aid and public funds used in joint ventures under Law 43 were counted as private sector finance (1).

One of the main reasons for the opening to foreign investment was frustration with the performance of the public industrial sector. It was supposed to operate within a planned framework with some decentralisation compared to the 1960s. After moves in that direction after 1975, controls were tightened in 1980. The need to control prices so as to reduce inflation involved tighter restrictions on the

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(1) Dr. A. Gritly, former Finance Minister and advisor to the Ministry of Economy, interviewed, and J. Waterbury 'Egypt: Burdens of the Past and Options for the Future' P298.

firm than those exercised by the rest of the planning system. Price controls were so restrictive that one firm, Delta, in the iron and steel sector, actually cannibalised equipment from one of its plants making price controlled products (which it found unprofitable) and set up production of uncontrolled goods.

### Emigration Policy

The emigration of Egyptian workers in the 1970s was not costless and is one of the most important examples of virtually unplanned economic change. The policies which permitted them to leave, represented a significant change in official thinking and added profoundly to the concept and reality of a liberal economy. Freeing emigration was not explicitly part of the liberalisation announced in 1974, but arguably had greater effects on the economy than any policy announced within the official framework. In permitting emigration the government recognised the potential foreign currency remittances which Egypt could earn. It caused a shortage of skilled labour inside Egypt and has added hugely to the inflow of foreign exchange.

From the mid 1950s until 1967 emigration was strongly discouraged. For most people it was virtually impossible to leave Egypt. In October 1967 a committee, which had been established three years earlier, suggested that emigration be encouraged. It advocated a policy which involved surveying the Egyptian labour force collecting information about labour markets abroad, simplifying the bureaucracy pertaining to emigration and encouraging emigrants to remit part of their savings at home. It also suggested that one agency handle all emigration matters (1).

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(1) Al Ahram 13.10.67 Al Ahram al Iqtisadi 17.10.67 quoted in A.E.H. Dessouki 'Development of Egypt's Migration Policy 1952-1978' Cairo University M.I.T. Programme, December 1978.

The consideration given to emigration was prompted by the slowdown in the economy and the growing problems of finding jobs for graduates with a rapidly increasing labour force. It was approved by those favouring a closed economy and by those who feared that a loss of skills would result.

From 1967 until 1973 various moves were made to encourage emigration and there was much discussion of the issue during the period 1968 to 1970. In 1969 28,000 people applied to emigrate compared to 15,000 in the previous six years. This sudden increase caused alarm and gave rise to a debate about the effects of emigration. Permission to emigrate was suspended in 1969 and in 1970 regulated emigration was permitted. The government wanted to encourage the emigration of all except those with certain skills (1). In 1971 the right to emigrate was enshrined in the constitution and in 1972 procedures for leaving the country were again simplified.

After 1972 numerous bodies examined the possibility of easing emigration procedures fundamentally; Dessouki lists 11 government committees set up or involved in this (2). They were unco-ordinated and there was no clear hierarchy indicating the relationship between them. The fact that so many government departments did sprout committees on the subject indicated that the question was important<sup>and</sup> that it was perceived as affecting many sections of society and economy. It also showed that the tide was turning decisively towards freeing emigration of controls altogether.

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(1) Ibid.

(2) Dessouki op cit P15.



A major impetus towards easing controls was the move towards closer cooperation with the oil rich Arab States after 1970. Supplying labour was Egypt's contribution to the Arab development process: particularly from 1973.

Table 9: Estimates of the Number of Egyptians Leaving Egypt to  
Work Abroad p.a., 1963-1976

1968	130,000
1969	165,000
1970	170,000
1971	220,000
1972	210,000
1973	505,000
1976	600,000

Source: Central Agency for Public Mobilisation and Statistics (CAPMAS) 'The Migration of population across the frontiers of the A.R.E. 1973-78' published quarterly  
Cited by Choucri et al, 'Migration and Employment in the Construction Sector: Critical Factors in Egyptian Development', Cairo University: MIT Technology Adaptation Programme, October, 1978. 1971 figures calculated by Choucri et al.

There is no consensus about the accuracy of official or other statistics on emigration. If the number of Egyptians living abroad in 1967 is excluded or assumed to be negligible then by 1973, according to the figures in Table 9, 1.425 million Egyptians were living abroad. This figure assumes no returns to Egypt among emigrants. As 600,000 left in 1976 and 505,000 in 1973, it is possible that up to 500,000 left in each of the years 1974 and 1975, especially as these were years of rapid growth in the oil rich states to which most Egyptians went. The total by the end of 1976 on this basis was 2.035 millions; again assuming no returns. From 1977 to 1980 two factors are likely

to have affected the pattern. Firstly growth in the oil rich states slowed down somewhat and it is very likely that emigration to these states declined as well. Secondly, there is evidence that emigrants, having amassed a sum of capital, returned to Egypt (1).

Emigration has resulted in a large increase in remittances received by Egypt. According to Table 4, remittances totalled \$29m in 1970 and £<sup>£</sup>2.95bn in 1980. In 1980 remittances were the most important single source of foreign exchange, exceeding petroleum. This would seem to be a major policy achievement given that foreign exchange was a constraint on development from 1963.

Such a view is reinforced by an examination of the domestic labour market. A lack of productive jobs has been a major problems for the last fifteen years at least. If labour could be exported then the excess supply of one factor of production on the domestic market could be converted into an inflow of badly needed foreign exchange. Looked at from this macro-economic point of view the policy has been successful. This is especially true if the contribution to the Arab economy (that of other oil rich states) is seen as a policy objective.

There were costs however. The first was inflation, caused by both demand and supply factors. The second was the effect on development of the emigration of skilled manpower which went beyond inflation and involved output losses.

Calculations of these costs have been attempted in relation to the construction sector by Choucri, Eckhaus and Mohie-Eldine (2). They

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(1) Personal observations.

(2) N. Choucri, R.S. Eckhaus & A. Mohie Eldine 'Migration and Employment in the Construction Sector: Critical Factors in Egyptian Development' Cairo University - M.I.T. Technology Adaptation Programme October, 1978.

showed how costs increased in the construction sector as wages were bid up and how the cost increases spilled over into other sectors thus boosting inflation. Although labour moved into those sectors which lost workers on emigration, there was more than a marginal increase in wages rates, designed to attract needed skills. Ironically, skilled construction workers from Western Europe had to be imported into Cairo to work as plasterers in hotels for example. There was a widespread shortage of highly skilled labour for industrial employment. The Egyptian labour market was very rigid: training did not respond to supply shortages or demand changes and so many bottlenecks arose. Skilled workers remaining in Egypt could therefore earn a rental income because they were in short supply. This could be quite large if their skills were required by the private sector. This differential was large enough to make it worthwhile importing the European workers mentioned above.

It is assumed that the 1980 average wage in the construction sector was between £E450-£E500 per annum and imported Western workers would not have worked for less than £E10,000 (and possibly much more) (1). Their rental income, in the Egyptian context, was therefore about \$9,500 or about 19 times the basic wage. Even allowing for the fact that wages in the construction sector were higher, those with skills could do well. The calculation here is very approximate and the number of imported workers was small. It does show the scale of the problem and the possibility for rental income caused by emigration.

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(1) The minimum wage was increased by 25% to £E20 per month in May 1980.

This compounded the inflationary effects of shortages of materials already discussed. Hence the macro-economic picture gained from an examination of particular labour markets gives a less healthy impression than that of the total labour market (1). Improving training and making the educational system more vocationally orientated was an important policy objective in 1980, but the response was belated (2).

The emigration of skilled workers can be seen in the context of a rigid domestic labour market. According to Birks and Sinclair, 75% of those working outside agriculture in 1979 were employed in the public sector and bureaucracy (3). This figure excluded the armed forces. In public employment a worker had security, partial protection against dismissal and inflation, a pension and the possibility of doing a second job. Such a worker would not necessarily have the time, ability, finance or even incentive to train for another job. There was therefore a large section of the workforce, often educated at university which would not emigrate nor move into other areas of employment.

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- (1) J. Birks & C.A. Sinclair 'Human Capital on the Nile: Developments and Emigration in the Arab Republic of Egypt and the Democratic Republic of the Sudan' International Labour Office, Geneva, World Employment Programme Research Working Paper, Migration for Employment Project, May 1978.
  - (2) Dr. Abdel Kader Hatem, Supervisor General, Specialised National Councils, Cairo, interviewed.
  - (3) J.S. Birks and C.A. Sinclair 'International Migration and Development in the Arab Region' I.L.O. Geneva 1980 P97.

Outside this sector relatively few workers had skills, according to Birks & Sinclair (1). In fact, their view may be outdated in that some public sector firms were, in 1980, finding themselves short of skilled workers as the latter moved into better paid private sector jobs. The bureaucracy and public sector were still growing in manpower terms and this locked many with an education into an immobile system, although the most able moved to the private sector.

Egyptians have been returning home in small numbers to settle permanently. Those who acquired capital by making use of their skills abroad have not necessarily wanted to work as artisans on returning home. Their capital allowed them to start small businesses, sometimes involving manufacturing but often as importers.

Emigration policy has demonstrated the lack of planning which has characterised Egypt since 1963/4. The decision to permit and facilitate mass emigration was made pragmatically, in response to factors which have been described. It was not accompanied by any plans to deal with the consequences. The decision was ad hoc in the sense that it dealt with an immediate problem: the shortage of foreign exchange. It was also a response to employment problems but only in a very general sense.

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(1) J.S. Birks & C.A. Sinclair op cit, P97.

### Conclusions

The foreign sector was seen as an area of opportunities. It was therefore reformed via the trade and exchange rate systems. This encouraged imports, foreign investment and capital inflows.

It was seen as an easy option for reform because it would and did result in an increase in the supply of commodities. Exports, other than oil, did not grow substantially because they were dependent on domestic production which went largely unreformed. This constrained domestic production and hence encouraged imports, given rising demand.

The foreign sector benefited from increased tourist, oil and Suez Canal revenues. These gains were related to political changes such as the reorientation from the Soviet block to the West and the improvement of relations with Israel. Remittance inflows were related to improvements in relations with the oil rich Arab States in the early 1970.

The decline in trade with the East meant the end of bilateralism and hence a reduction in state control. This also weakened the mechanism which tended to balance trade between Egypt and her trading partners.

Egypt made full use of the opportunities for capital imports exporting labour and selling oil abroad. These funds paid for increases in imports which were largely unplanned. They also helped to supplement domestic savings. Few of these developments affected the exports of industry and agriculture.

## Chapter 8: Conclusions

Egyptian economic policy in the 1970s was extremely successful in one respect. It increased the total resources available to the economy dramatically.

Total resources are defined as GDP plus the excess of imports over exports. The ability of an economy to persistently run a balance of payments deficit reflects its credit-worthiness abroad. Before 1978-79, deficits on the balance of payments resulted in a build up of short term foreign debt and consequent financing difficulties. After that date increased foreign aid made it unnecessary even to receive the blessing of the IMF for economic policy (1).

GDP was increased as a result of the growth of rental sector incomes. These included oil, Suez Canal tolls and emigrant remittances. Table 4, Chapter 7, provides data on the size of these items in dollar terms. Converting them into domestic currency provides a crude indication of their contribution to the national income.

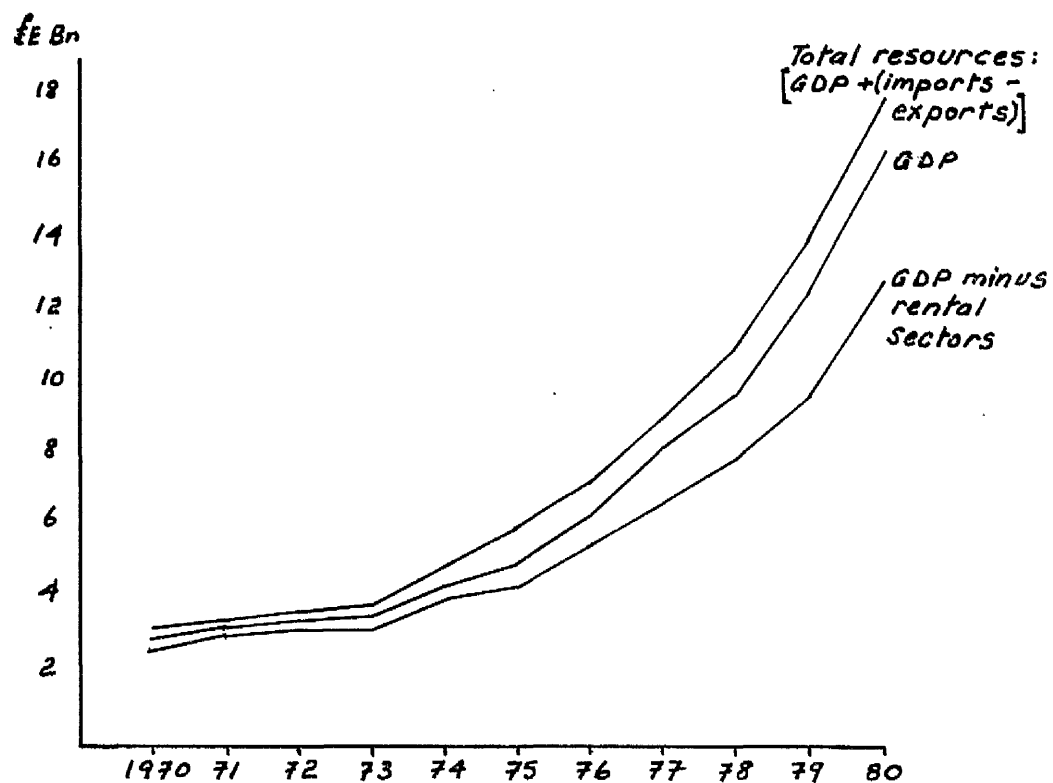
Table 1 below shows the relationship between GDP, the rental sectors and the balance of payments deficit in current prices. Table 2 shows the same relationships in constant price terms.

The massive expansion of foreign exchange resources in the late 1970s provided Egypt with an opportunity to overcome what were thought to be one of the major constraints in her development. From 1963 onwards shortages of foreign exchange constantly blocked expansion of the economy. Evidence was presented in Chapter 4 that a step-like increase in public sector production occurred when foreign currency supplies increased in the late 1970s but stagnation set in afterwards.

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(1) See Appendix 1.

**TABLE 1: TOTAL RESOURCES, GDP AND THE RENTAL SECTORS  
1974-1980 IN CURRENT PRICES**



SOURCE: Table 3 below



Table 1a: GDP, The Rental Sectors and Total Resources 1970-1980 £EM  
(Current Prices)

		1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
GDP		2971	3146	3413	3663	4197	4886	6297	8210	9782	12475	16804
of which												
-Rental Sectors	1	28	15	69	135	172	391	889	1345	2072	2902	4031
Exports minus Imports	2	121	158	192	198	505	937	938	790	1371	2002	1425
Total Resources	3	3092	3304	3609	3861	4702	5823	7014	9000	11513	14477	18229

Sources: GDP, Exports-Imports: International Financial Statistics IMF 1975-1983  
Rental Sector: Table 4 Chapter 7.

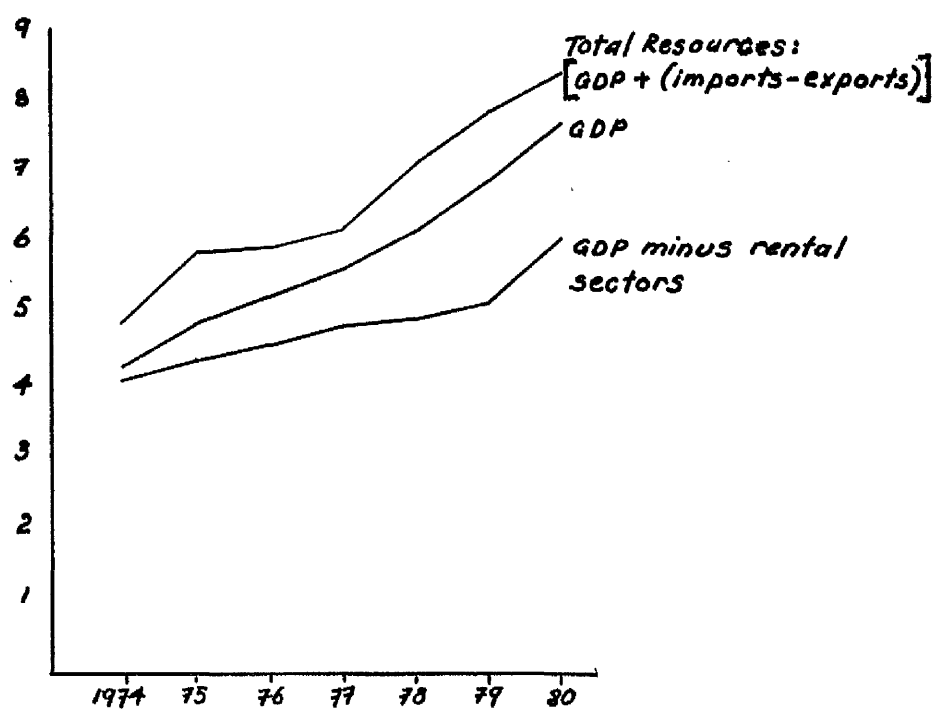
1970 and 1980 are fiscal years July-June, 1972-79 calendar years.

Notes:

- (1) Oil, Suez Canal tolls and remittances
- (2) National Income definition
- (3) GDP and balance of imports over exports.

**TABLE 2: TOTAL RESOURCES, GDP AND THE RENTAL SECTORS**  
**1974-1980, IN CONSTANT PRICES**

£Ebn



SOURCE: Table 4 below

Table 2a: GDP, The Rental Sectors and Total Resources: 1974-1980  
(in 1975 prices)

	1974	1975	1976	1977	1978	1979	1980(4)
GDP	4297	4886	5269	5683	6226	6766	7767
of which							
-Rental Sectors(1)	207	391	748	927	1290	1535	1744
Exports -Imports(2)	518	937	621	540	867	1078	655
Total Resources (3)	4815	5823	5890	6223	7094	7844	8418

Sources: GDP & Exports-Imports: International Financial Statistics,  
IMF, 1983.

Rental Sectors: Table 4, Chapter 7.

Notes: 1980 = Fiscal year: July - June, 1974-79 Calendar years.

(1) Oil, Suez Canal tolls and remittances

(2) National Income definition

(3) GDP + balance of imports over exports

(4) GDP deflator unavailable: Consumer price index used  
instead.

increased

The availability of foreign exchange was not accompanied by the changes in the organisation and control of the public sector. The economy became more dualistic than before despite the development of joint ventures between the public and private sectors under the terms of Law 43.

An important conclusion can be drawn from the analysis. The relationships between the public and private sectors and the private sector plus the bureaucracy tended to reduce pressure for reform. Foreign exchange provided the funds for buying licences, paying bribes or meeting black market prices. The private investor could get round bureaucratic and policy constraints more easily at the end of the decade than at the beginning because more resources were available. Greater returns could be earned from, for example, an import licence because there was more finance in the economy to pay for imported goods. There were therefore greater incentives to find ways around the obstacles.

At the same time the bureaucrat had every incentive to fight for his job. He could increase his income (both legally and illegally), status and power from a situation in which more entrepreneurs wanted licences for various activities.

Both the private sector and the public bureaucracy had incentives to maintain the status quo. The development of rental incomes and increased foreign aid tended to reinforce this. It was not only as a result of rental income and foreign resources that reform was subverted. Foreign resources played little more than a passive role permitting other developments such as a growth of imports.

The earning of rent was widespread and created a whole network of interests in favour of the status quo. Subsidies coupled with shortages of basic commodities created dual markets with opportunities for reselling items on the black market. Low domestic energy prices encouraged the use of private cars, generating income for importers among others. Low interest rates compared with those which would clear markets implicitly subsidised those who had favourable access to credit and enabled public sector to survive the rigours of price controls. Easing emigration not only provided remittances in cash and kind but enabled skilled workers in Egypt to earn rental incomes because of their short supply. An over-valued exchange rate subsidised all imports.

Practically everyone in the country had some interest in the existing system, even if it was only in the short term. Reforms may have boosted the economic growth rate by increasing efficiency but that would have been a future gain to be traded against possible current losses or adjustments.

This was the nature of Egypt's middle way. The centralised control of the early 1960s was rejected while complete laissez faire was not even considered. It is useful here to examine briefly the reasons why extreme policies were not adopted.

The gist of advice given by Little, Scitovsky and Scott (2), Bhagwati (2) and Krueger (3), among others, was that developing countries such as Egypt should move away from import substitution (IS) towards export promotion (EP). They suggested that IS, together with the policies which usually accompany it, formed a chaotic mix. This was certainly true for Egypt in the early 1970s. Streeten has made the point that both inward looking IS policies and outward looking market orientated ones (such as EP) can increase inequalities in income distribution (4). This is because the former strengthen market imperfections inside the country and can reduce demand for labour intensive processes. The latter may reward scarce factors and penalise those in abundant supply. Hence capital and management do better than workers. In a market orientated system, international companies tend to expand production of goods and services with increasing returns; while developing countries concentrate on either non-increasing returns or relatively slowly increasing returns sectors. The economic

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- (1) I. Little, T. Scitovsky and M. Scott 'Industry and Trade in some Developing Countries'
  - (2) J. Bhagwati 'Anatomy and Consequences of Exchange Control Regimes'
  - (3) A.O. Krueger 'Liberalisation Attempts and Consequences'
  - (4) P. Streeten 'Trade Strategies for Development, Some Themes for the 1970s' in P. Streeten ed, 'Trade Strategies for Development' Macmillan, 1973.

mechanism tends to reinforce existing power relationships to the advantage of more developed states. Technology available on international markets is most suited to its suppliers in that it is relatively capital intensive. The capital intensive nature of foreign investment in Egypt has been noted in Chapter 7. The products of this technology do not always meet the needs of those on low incomes.

Stewart partially integrated the critiques of IS and EP (1). The failures of IS are those of inappropriate technology and output; EP may not necessarily solve those problems.

The types of policies accompanying EP, according to Krueger and Bhagwati, cause growth to accelerate if certain conditions prevail. The necessary condition is that the additional supply of (Egyptian) exports would not result in lower prices on international markets. This was a fear with regard to cotton exports before the 1970s, which resulted in an export tax, but the assumption may not be, in general terms, unreasonable.

Abdel Fadil (2) has shown how income inequality grew in the 1960s under a regime of import substitution, but this was not the inevitable outcome of the trade policy adopted. It had much more to do with the accumulation of private profits in the construction sector and the nature of land reform than inappropriate technology.

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(1) F. Stewart 'Trade and Technology' in P. Streeten ed, op cit.

(2) M. Abdel Fadil 'The Political Economy of Nasserism'

Inequalities in income distribution, consumption patterns causing social and political tension, slow economic growth and agricultural stagnation were problems in the 1960s. These issues persisted in the 1970s, despite the changes in economic policy. In some respects, production might have been stimulated by liberalising the price system. Given the problems suggested by Streeten, further liberalisation of the trade system would not necessarily have eased Egypt's problems. Adopting a completely free market system domestically was not possible either. The events of January 1977 show why.

The other extreme alternative was to override the market with centralised planning. To the extent to which this was experienced the results were unsatisfactory. Egypt suffered many of the problems because ownership of the areas of production was not separated from the idea of control. As the state owned the public sector it controlled it in a very detailed way. The idea that ownership could remain public while control was decentralised, was unacceptable in the 1960s and hard to implement in the 1970s. The centralised control system did not exercise full control however. It did not control private consumption nor could it raise taxes sufficiently. The public sector was unable to increase its savings to a point where they would meet investment. As a result the economy relied on imported finance to a growing extent.



There was a deeper reason why centralised control was unsuccessful in the 1960s for more than a few years. The regime was not ideologically committed to the radical change in attitudes that would have been needed. It gained its support, in part, from opponents of socialism (1).

Given the dangers of extreme policies, it would seem that a middle way was preferable. This might have involved partial liberalisation of the exchange rate, trade, price and investment systems without, for example, ending food subsidies. Egypt followed a middle way, but this, too, was unsatisfactory.

The main reason was that the mixture of liberalisation and central control was, in part, an unplanned reaction to economic and political pressures. The foreign exchange system was modified in order to encourage the remittances of Egyptian workers abroad and restrictions on emigration were eased. Foreign policy reorientations in the early 1970s made it possible to attract Arab finance. Those in the late 1970s made American assistance possible. The mixture of foreign policy and economic adjustments was highly successful in that substantial amounts of economic aid were obtained. American military aid replaced Soviet military aid as well. The need for foreign aid has been consistently recognised by the Egyptian leadership and in view of the country's complex international relations, she has been successful in attracting assistance.

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(1) B. Hansen 'Arab Socialism in Egypt: World Development' Vol.3 No.4 April 1975.

Domestically, the need to maintain the massive and growing employment of civil servants and public sector workers made reform hard. Most production in the economy in the 1970s was under a command system, as in the 1960s. Public sector firms had to get ministerial approval for investment, pricing output and employment policy changes. The ministerial decision making process was neither efficient in terms of speed nor in terms of decisions given. Fear of inflation in public sector products meant that prices were not allowed to increase freely; sometimes, as in 1980, they were actually cut, despite rapid inflation and shortages in the economy as a whole. Unwillingness to face the implications of enforcing higher productivity meant that over-staffing persisted. The concentration of power at the top meant that detailed decisions about policy had to be taken by ministers.

The command system was not completely pervasive however. Law 43 firms could legally avoid many economic controls, but the 'Open Door Sector' which operated under that law tended not to produce basic commodities purchased by the mass of the population. The latter did not therefore derive benefit from the more competitive environment in which Law 43 firms were supposed to operate.

The public sector suffered from the worst of both worlds. The private sector flourished mainly in areas of doubtful socio-economic value, while the public sector stagnated behind bureaucratic controls. In agriculture, controls were partially evaded, but total production stagnated. Agriculture continued to be starved of investment resources, despite the partial reorientation of economic policy.

This was despite the experience of slow production growth in the 1960s, a food crisis in the 1970s and the growing international realisation in recent years that countries which developed fastest were those which gave priorities to agriculture (1).

Egypt's leaders expected a great deal from the outside world. Having been isolated for years from most countries outside the Soviet bloc, they thought that simply opening the economy to foreign trade and investment would solve the problems. For this reason, Law 43 companies were supposed to find their own foreign exchange needs by exporting, even though many projects were expected to be import substituting (2).

Some decision makers knew that internal adjustments would have to accompany external ones. Dr. Hegazi's desire to link public sector wage rises to productivity increases has been mentioned. He was defeated in the political arena because it proved impossible to hold down wages in the face of price rises (given the complexities of initiating productivity increases), while large profits were being made by some in the economy.

By 1980 this problem had reached crisis proportions. The President intervened to increase wages and cut prices in the face of accelerating inflation and shortages of commodities. In so doing, he did more to reverse the process of liberalisation than anything he had done since 1970. The sequence of policy measures during 1980 is examined in Appendix 2.

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(1) e.g. World Bank Development Report 1979

(2) R.E. Driscoll, P.F. Hayek and F.A. Zacki 'Foreign Investment in Egypt: An Analysis of Critical Factors with Emphasis on the Foreign Investment Code'

The problems behind this were in part recognised. The 1980-84 plan contained the following remarks:

'....the open door policy reflects a major turning point in the economic management of Egypt for which legislative acts alone would be insufficient. A number of institutional organisational and indeed behavioural changes are necessary ....' (emphasis added) (1).

A speech given by the then Minister of Planning with the same title as the document quoted above appears to have the same text with a number of significant changes. One is that the sentence emphasised above was put in the past tense, suggesting that behavioural and other changes had been achieved (2).

In this way, one of the most important issues which has faced Egypt in its independent history has been both recognised (but not defined in detail) and ignored. The need for change was said to be the result of trying to combine a high rate of growth, social justice and rigid central planning in the 1960s, high defence expenditures, plus the effects of the 1967 War, the low rate of investment after 1967 with a background of ever increasing population. Two constraints had to be removed before progress could be made: the balance of payments had to be improved and the nation's social and economic infrastructure rebuilt. The need for change was not explained in terms of analysing the way in which people have behaved in the economic sphere.

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- (1) Ministry of Planning 'Egypt's Development Strategy, Economic Management and Growth Objectives, 1980-84' November, 1979.
  - (2) Minister of Planning, undated speech : 'Egypt's Development Strategy, Economic Management and Growth Objectives 1980-84' dated 1979.

The President also recognised some of the problems; in creating the Arab International Bank as early as 1971, he hoped to bypass the bureaucracy. The main aim of the Bank was to make foreign currency available from the oil rich states and Egyptian emigrants. He complained about problems of administration and authorised numerous changes in the organisation of government. None of these moves tackled the basic problem of how production in the economy was controlled.

The government did not feel able to free firms from Ministerial control because there was no political consensus about how the economy was to be reformed. Attempts to loosen ministerial control appeared to workers as a retreat from socialism towards the capitalism of pre-1960 Egypt of that of the Law 43 firms. Neither represented an acceptable alternative. Ultimately, the problem was one of accountability. The government and the President had one basic task: to provide enough food for the population on a day to day basis. Radical changes in organisation and management result in changes in the balance of power. This could have caused instability in a delicately balanced political system. With so much power concentrated in the hands of the President, there were disincentives to do anything which might disturb the existing order. The Open Door was conceived as a means of attracting resources to the economy, not fundamentally as a way of changing its organisation. For that reason, change in the external sphere - permitting emigration, encouraging the inflow of remittances, changing foreign relations in part to attract foreign aid, plus investment and easing imports - was much more radical than that inside the economy.

The regime was unable to separate the ideas of ownership and control. It did not feel strong enough to persuade workers that they would ultimately benefit from a decentralisation of the public sectors decision making. On this crucial issue (as in so many others such as collecting income tax or controlling imports), it avoided confronting an important group in society. As a result, the public sector operated along different lines from the private sector. This was much to its disadvantage. It did not gain directly from the increase in foreign funds except for the step-like increase in production. Resources were not used to cushion those who would suffer in the short term from the adjustments inherent in a decentralisation policy. Everyone gained from the status quo (although some gained much more than others), but they lost in terms of not achieving the long term advantages of reform. The availability of an easy option in terms of the rental sectors delayed the painful day when reforms would have to come.

By 1980 Egypt somewhat resembled the rental economies of the Gulf to a certain extent (1). Foreign currency flowed into the Treasury and into the private sector. This increased the state's ability to bribe pressure groups in order to maintain the status quo. Egypt had a large industrial sector with considerable potential. The rental sectors provided a cushion for making long overdue reforms leading to long term gains. By 1980 however this had not been done. In so far as so much power was concentrated in the hands of one man - the President - so the assassination which occurred in 1981 may lead to reforms.

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(1) As described by H. Mahdavy 'The Pattern & Problems of Economic Development in Rentier States: The Case of Iran' in M. Cook ed. 'Studies in the Economic History of the Middle East'.

## APPENDIX 1

The Relationship between Egypt and the IMF

The relationship which developed between Egypt and the IMF was a result of the liberalisation policy and the problems which the country faced in the period after 1975. It was very different from the relationship between the international organisation and some other developing countries in the 1970s. This was mainly due to the role of the USA and the Gulf Arab States.

Egypt sought links with the IMF in the 1960s and much more intensively in the 1970s, as a way of securing finance on international markets. Traditionally the IMF provided developing countries with a seal of approval enabling them to obtain official and private sector loans. The seal was granted if certain criteria relating to economic management were met. These included control of the money supply, budgetary control, exchange and trade liberalisation. In the Egyptian case, the setting of targets for these variables became an intensely political matters.

By the end of 1976 Egypt was \$452.9m in arrears on its short term debt repayments. That debt was about \$1.3bn and to it should be added medium and long term debts of \$5.585bn (1). This situation was a result of the continuous rise in the import bill, weak growth of exports and the very irregular inflow of the mainly Arab aid which

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(1) K. Ikram 'Egypt: Economic Management in a Period of Transition' op cit P351 & P364 and Middle East Economic Digest (MEED) 14.1.1977 P4. According to Dr. Kaissouni, interviewed, debts in 1977 amounted to \$12bn of which \$4bn were military.

covered most of the current account deficit. The current account deficit was reduced to \$1.838bn in 1976 compared with \$2.615bn in 1975 (1). Between those years total Arab assistance to Egypt fell by \$1.072bn.

During 1976 the debt crisis came to a head and led to the appointment of Abdel Moneim Kaissouni as Deputy Prime Minister for Economic and Financial Affairs. He was given wide powers and immediately appointed a new team of Economic Ministers. Until his appointment the government, headed by Prime Minister Mamdouh Salam, had no senior economic minister with a coordinating role. The focus of Dr. Kaissouni's efforts was to reduce the budget deficit and further the liberalisation of the economy. It was decided that reductions in expenditure would get priority over attempts to float the Egyptian pound, at least in the short run (2).

During 1976 discussions with the IMF emphasised the floating of the currency, which would have involved a substantial devaluation. The new economic team changed the emphasis of policy and with undertakings that the budget deficit would be reduced, a \$450m loan was agreed with the Fund. This sum was to be made available over three years and access to it would be subject to the adherence to the agreed targets. The availability of these funds would make possible a floating of the pound at a future date (3)

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(1) MEED op cit

(2) MEED op cit

(3) MEED op cit



The January 1977 budget brought increases in import duties on luxury goods. Subsidies were reduced on a number of goods resulting in price rises of 16% for sugar, 31% for petrol, 12% for cigarettes and 46% for cooking gas. Before the budget was announced there had been disturbances as a result of price rises but the new measures were followed by widespread and serious rioting. According to press reports, 73 people were killed and 2,000 arrested (1).

There were precedents for the unrest: in 1978, 1973 and 1975 riots had occurred for various reasons. They usually occurred in the winter when the need for heating and warm clothing pushed up living costs and increased hardship among the urban poor. Following the 1977 riots, the price rises were withdrawn.

The January 1977 budget was the first major attempt to reduce spending in the economy since the beginning of the liberalisation programme. The aim was to obtain IMF approval of the economic progress and thereby gain access to increased Arab and other funds. These funds would reduce or remove the need to borrow on short term markets at high rates of interest. The government's problem had become more acute as a result of the riots because it could not easily reduce its expenditure. The budget deficit, according to Ikram, equalled 20.0% of GDP in 1976 and this was felt by the IMF and others in Egypt and abroad to be excessive (2). The budget included annual pay rises and

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(1) Financial Times (F.T) 18, 1977 P22.  
The Times 19th, 20th & 26th 1977.

(2) K. Ikram 'Egypt: Economic Management in a Period of Transition'  
P325.

other benefit increases. As they were not related to productivity they were considered inflationary and the need for restraint therefore intensified (1).

The riots were the most serious experienced in Egypt since the 1952 revolution and posed a major threat to social stability. External finance was more urgently required and a political element had been added. The stability of the country dependent on such an inflow. In April 1977, the Gulf Organisation for Development in Egypt (GODE) agreed to provide \$1.475bn in balance of payments support for that year, on the assumption that a deal with the IMF would be agreed (2). GODE also underwrote a \$250m loan on the Eurodollar market. The IMF agreed to a \$146m standby programme (3). In May 1977 the Consultative Group for Egypt (made up of GODE, Iran, Japan, Western nations, the IMF and the IBRD) gave its blessing to Egypt's economic policies. Short term debt repayments began again (see Tables 23-25, Chapter 6) and more funds were made available for investment.

Domestic problems were severe however: the budget deficit was reported in July 1977 to be double the level that it had reached in January. According to the Undersecretary in the Finance Ministry, this was due to large scale overspending (4).

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(1) Financial Times (F.T) 22.6.1977.

(2) Middle East Economic Digest (MEED) 31.11.1977.

(3) F.T. 11.5.1977

(3) Katub Ibrahim quoted by Al Goumhouria, in MEED 8.7.1977.

By November of that year the government was negotiating for a \$600m loan from the IMF over a three year period, instead of the \$450m. This was the culmination of a major improvement in the capital account. This also reflected to the increase in long term loans received between 1976 and 1977.

Unlike many other developing countries, Egypt was able to get economic assistance before agreement with the IMF was reached because there were other sources of finance available to her.

The measures introduced only partly met the initial IMF requirements and so the relationship developed with the international body was only a tenuous one. The size of the IMF's direct contribution was modest in terms of Egypt's overall requirements but their initial availability did provide a seal of approval favoured by other potential lenders.

In April 1978 the \$600m IMF credit was still under discussion. As part of the negotiations Egypt considered reviewing the subsidy system and allowing interest rates to rise (1). Discussions continued on floating the pound. During 1977 more important transactions were moved into the parallel exchange market which effectively increased their cost in terms of domestic currency. Investment funds brought into Egypt under Law 43 could be repatriated at the parallel rate under an amendment to the Law introduced in 1977. In July 1978 agreement was reached with the IMF on a loan of \$750m (2). It, too, was to run for

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(1) MEED 7.4.1978 P4

(2) F.T. 2.8.1978

three years and represented a special case allowance by the Fund. This meant that the conditions attached to the loan were more lenient than previous ones. Following the announcement of the agreement, further Arab funds were made available out of the \$2.0bn GODE capital.

Under the agreement Egypt received balance of payments assistance because of the structural problems she suffered. The government undertook to review the economic structure, adjust costs and prices, optimise the use of resources, give priority to irrigation and drainage, amongst other things. The exchange rate system was to be reformed and bank borrowing was to be cut as the fiscal deficit was reduced. Interest rates were to be raised, interest on savings was to be tax exempt and subsidy cuts were to be re-examined.

By November, 1978 there were signs that the budget deficit was exceeding the limit agreed with the IMF and as a result the 15th November 1978 tranche of the IMF loan could not be drawn (1).

During 1977 only \$105m was drawn from the IMF because Egypt exceeded the budget limits. The Fund was concerned that without restraints on domestic expenditure external debts would mount and servicing problems would recur. The United States was anxious that Egypt not be pushed into a deflationary policy after the events of January 1977. According to the 'Economist', pressure was put on the IMF by the USA to ease the terms to be imposed on Egypt. It was this pressure which resulted in the special case facility already mentioned (2).

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(1) F.T. 24.11.1978

(2) The Economist 9.12.1978.

The 1978 fiscal deficit was substantially higher than that in 1976 and 1977, although current operations, public savings and debt figures showed improvements. In May 1978 Dr. Kaissouni resigned as a result of disagreements within the government but he was not replaced. The Cabinet lacked a Minister with coordinating powers in economic matters until May 1980.

The 1979 budget was calculated at a single exchange rate for the first time, the main effect being to push up the currency costs of items formerly imported at the relatively high official rate of exchange. This simplification and effective devaluation of the exchange rate was a major step in the programme of liberalisation advocated by the IMF. One consequence of using a lower rate was to increase the costs of subsidised commodities domestically. They rose from £E679.7m in the revised 1978 budget to £E1.179.9m in the budget proposed for 1979, an increase of 73% (1).

By February 1979, a drawing from the \$750m fund was blocked. This was the second to be so. Once again the budget was exceeding the agreed limits and, more significantly, there was disagreement over the 1979 budget plans; despite the move to a lower exchange rate (2). The Egyptians hoped for US pressure on the IMF to ease its terms at a time when foreign exchange shortages were becoming less serious. By the end of 1979 the agreement, reached in 1978, had collapsed.

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(1) MEED 26.1.1979

(2) The Economist 3.3.1979.

At the beginning of 1980 negotiations began for a new agreement which Egypt hoped would be worth \$1bn (1). An agreement for \$600m was initial~~ed~~ed in February 1980 (2).

The amount was smaller than originally hoped for because of improvements in the balance of payments which were by then becoming apparent. By November 1980 the \$600m deal had also broken down (3). This was due to the radical change in budgetary policy which occurred during that year. The continued strengthening of the balance of payments<sup>pushed Egypt</sup> away from the types of policies favoured by the IMF.

The relationship with the IMF reflected a series of economic and political factors. Firstly, between 1976 and 1980 Egypt's external account was transformed by increased oil, tourist, Suez Canal and remittance revenues. Her need for IMF aid and the mark of respectability which it conferred, decreased. She was in the fortunate position of having close links to the oil rich states, some of whom had a direct interest in her political and social stability. Having moved away from an interventionist policy in the Arab world and having started a liberalisation of her domestic economy, Egypt was a more attractive partner for some of the oil rich states. Her international position vis a vis Israel meant that the USA had political reasons for providing economic support in certain circumstances. These were all factors which gave Egypt a special position amongst the nations which, during the 1970s, applied for assistance to the IMF.

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(1) F.T. 8.2.1980

(2) F.T. 22.2.1980

(3) F.T. 5.11.1980.

Economic policy operated at two levels during the period of retrenchment in 1977. At the ministerial one Dr. Kaissouni and his team concentrated on reorganising the subsidy system, which they considered to be irrational. By this they meant that subsidies were benefitting many who did not need them (1). This policy was made difficult by the higher level of international prices which prevailed for wheat and oil imports. The latter factor had enriched Arab oil states after 1973 and many Egyptians felt that the War which they had fought in that year had made the oil price rise possible and effective. This is debatable, but the perception of Arab oil wealth contrasted with the increased need for austerity in an already poor Egypt; caused at least in part by the need to pay more for oil. However, the aim of reducing subsidies was only partly achieved.

At another level, the appointment of Kaissouni by the President can be seen as an attempt to speed up the liberalisation of the economy, so as to increase the amount of foreign aid available to Egypt. It is possible that the President was unaware of the difficulties involved in rationalising the budget and the January 1977 riots must have made him wonder what the advantages of such a policy were. About 18 months after his appointment, Kaissouni's resignation was accepted; by 1978 the short term foreign exchange crisis had been dealt with. The 1977 riots contributed to a realisation in the USA and elsewhere that Egypt could not adopt international prices for basic commodities and that she needed increased aid from abroad.

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(1) Dr. Kaissouni, interviewed.

From 1978 until early 1980 minor attempts were made to reduce subsidies but little was achieved. Following the changes announced in May, 1980, when subsidies were increased, it can be concluded that Sadat's commitment to 'budget rationalisation' as part of the liberalisation programme was very pragmatic. He went along with it in order to attract foreign aid as long as it did not cause social and political problems at home.



## APPENDIX 2

Economic Policy Since 1980: Choices with Fewer Constraints

The unplanned and uncoordinated nature of policymaking was highlighted in dramatic policy changes announced in 1980. These showed how fiscal policy was largely unrelated to overall planning.

Between 1978 and 1980, the balance of payments was radically transformed. The estimated current account deficit of \$1.35bn in 1980 was more than covered by inflows of aid, foreign investment, supplier credits and remittances (1). During 1979, the increase in oil prices and the recovery of oil fields in the Sinai had made prospects for the balance look optimistic for the first time.

On the political front, there had been a transformation between 1977 and 1979. The peace treaty signed with Israel in 1979 meant that Egypt was not in a state of war, for the first time since 1948. However, the negotiations leading up to the peace treaty were arduous and lengthy. Opposition at home meant that the regime was anxious about domestic security and so its economic policies were adjusted accordingly. The peace treaty had, to some extent, been sold domestically on the grounds that it would contribute towards prosperity.

Subsidies could not be cut in such a context by any more than a marginal amount. On 14th May, 1980, as inflation accelerated, the President announced major economic changes (2). These included a 25%

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(1) Financial Times (F.T) 6.10.1981 Supplement, P2.

(2) According to the Ministry of Economy, foods prices were increasing at 50% p.a. and the overall consumer price index at about 40% p.a. in the first half of 1980. 'Recent Developments in the Egyptian Economy', Ministry of Economy, ESU January 1981.

increase in the minimum wage to £E20 per month. Certain prices were reduced and workers were exempted from defence and national security taxes. Private sector workers were to get a 10% wage rise. The measures were followed by the resignation of the Cabinet and the President assumed the Premiership, heading a new one.

The new Cabinet quickly introduced a new budget, having redefined the financial year to start in July. It was organised to show a surplus by the removal of investment from the budget. The previous budget contained a £E3bn deficit.

The new 1980/1 budget was the first for many years to contain no price rises, but most of the other changes were presentational and it had to cover the increased wage and subsidy expenditures ordered by the President. Public sector civil service wage increases were not tied to productivity, and so were inflationary. Unlike its predecessor, the 1980/81 budget did not have IMF approval (1).

The direct emphasis on fighting inflation by restricting the upward pressure on prices, contrasted with earlier anti-inflationary policies which attempted to reduce subsidies in order to cut the budget deficit. The June 1980 budget reduced the price of 400 commodities. Public sector companies faced increased foreign competition at the time, as a result of the Open Door Policy. This was due to imports, rather than domestic production under the foreign investment code, although the latter did portend greater competition within the economy. Yet, economic policy at this time restricted their ability to compete even further (2)

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(1) F.T. 12.6.1980

(2) F.T. 5.6. 1980

Inflation was the main problem facing the President, in that it threatened the living standards of urban workers. The public sector and its problems took second place. The Presidential statements reflected this anxiety about inflation. The problem was apparent in 1975, when the rise in the consumer price index was 9.7%.

In 1975 President Sadat said:

I have noticed that the cost of living has gone up to an unbearable level .....if we are not capable of putting an end to the corruption and controlling the increase in prices, we would be facing a very serious situation. (1).

By 1980, when prices were rising at 20% annually, he said:

....the people must get what they need at suitable prices ... aid should reach those who need it, not the hotels or pockets of merchants ....the present criminal rise (in prices) must stop immediately. (2).

There have been a number of responses to inflation. The first, already discussed, was to freeze many public sector prices. This was done because many of the public sector's products were those on which the workers and poor relied. A second kind of response was exemplified in the events of September 1980.

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(1) Arab Report & Record 1-15 April 1975.

(2) Summary of World Broadcasts, BBC, 9.9.1980

In that month, the prices of unrationed sugar and edible oil were doubled. Rationed amounts of these commodities were not sufficient to meet market demand and many relied on buying unrationed supplies. No public warning was given on the price rises and when they were implemented, government shops which sold these items were physically attacked. Within days, the price rises were withdrawn. The aim of the price increases was to reduce shortages by cutting demand. It is not clear whether the extra revenue would have gone into increasing the supply of sugar and oil, or simply added to general revenues.

Also, in September 1980, the sale of meat was banned for one month. This was decided by the President and no Cabinet Minister defended the decision in public. Meat prices had been increasing rapidly prior to September and President Sadat wanted to deal with traders and sellers of meat, who were thought to be profiteering from the inflation. Meat was not consumed by the poorest sections of the community in Egypt and so the President would, in theory, gain popularity from those who ate it by dealing with the inflation without restricting the consumption of the poor, who have very limited ability to substitute one item of consumption for another. In fact, those who could afford meat shifted their consumption to such substitutes as eggs and poultry, thus pushing up prices of the latter; the elasticity of supply for these, like many other foodstuffs, being low. This latter effect hit the poor as prices for eggs and poultry rose at the same time as the price rises were being announced for sugar and oil.

A number of issues are involved here. Firstly, the meat sales ban was a political act, admitted to be such by the President, who took full, personal responsibility for it. The economic consequences of the meat ban were either not calculated, or pointed out to the President and ignored. They were, from his and the government's point of view,

highly undesirable, because the indirect effect on the cost of living of the poor had the effect of a trick. Its political consequences therefore backfired.

Secondly, the timing of the move was unfortunate in that the unplanned economic effects, which were inflationary, coincided with other measures by the government which were, at least in the short term, inflationary. The decisions about the price of oil and sugar were made by the government on the basis of a Cabinet decision. The meat decision was the President's, and was probably taken against ministerial advice. Timing, coordination and a feel for the social consequences of measures were all weak, but were only a pale reflection of the miscalculations of January 1977.

The measures had two different sources; one came from the government, the other from the President. It was politically and constitutionally possible for the President to over-rule the government and introduce immediate measures of which they disapproved.

Subsidies affected that rate of inflation in a number of ways. In the short term, they held prices down, but in the longer run they had to be financed by inflationary means. They also helped to sustain a higher level of demand for subsidised goods than would have otherwise existed, something which detracted from exports. Subsidies also had allocative effects; they effected the efficiency of the economy and, as a result, the pattern of production.

According to the President, the Open Door Policy had, by 1980, led to a 'disturbance in the balance of incomes'. He also referred to an 'income gap' and implicitly recognised that income inequality was increasing (1)

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(1) Egyptian Gazette 3.9.1980.

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